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No. 07-586

In The
Supreme Court of the United States

ROBERT S. CUILLO, et al.,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Does the *prima facie* crime-fraud test followed by the D.C., Third, Fifth, Ninth, and Eleventh Circuits (requiring identification of the crime-fraud and evidence of the essential elements) better distinguish between crime-fraud and the universe of other conduct, than the Seventh Circuit holding that no crime or fraud need be identified and no evidence need exist as to the essential elements of the unidentified crime-fraud?

2. Should the title contemporaneously enacted by Congress be considered in construing the statute as a whole or be ignored unless and until the Court first concludes that the textual portion of the statute contains some ambiguity?

RULE 14(b) STATEMENT

A list of all parties to the proceeding in the court whose judgment is the subject of this petition is as follows:

Petitioner-Appellant, Cross Appellee:	United States of America
Respondent-Appellee:	BDO Seidman, LLP
Intervenors-Appellees, Cross Appellants[1]:	Robert S. Cuillo Shahid Kahn Ray Lane R.K. Lowry, Jr. John P. Moffitt Arlene Nussdorf Glenn Nussdorf and Claudine Strum Glenn Nussdorf Trust Stephen and Alicia Nussdorf Stephen Nussdorf Trust Ruth Nussdorf Quality King Distributors, Inc.

[1] Earlier named Intervenor/Clients have since resolved or submitted their cases.

RULE 29.6 STATEMENT

No parent corporation and no publicly-held company owning 10% or more of any corporation's stock is a party to this proceeding.

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PETITION FOR A WRIT OF CERTIORARI

The Client/Intervenors respectfully petition for a writ of certiorari to review the opinion and judgment of the United States Court of Appeals for the Seventh Circuit.

JUDGMENT FOR WHICH REVIEW IS SOUGHT

The opinion of the Seventh Circuit is published at 492 F.3d 806 (7th Cir. 2007), and is reproduced in the Petition Appendix A ("Pet. App.") at pp. 1a-50a. The opinions of the United States District Court for the Northern District of Illinois are published at 2005-1 USTC ¶ 50,264 (N.D.Ill. Mar 30, 2005); 2005-2 USTC ¶ 50,447 (N.D.Ill. May 17, 2005); and 2005-2 USTC ¶ 50,578 (N.D.Ill. Aug 30, 2005). They are reproduced at Pet. Apps. B-D, pp. 51a-111a.

JURISDICTION

The judgment of the Seventh Circuit was entered on July 2, 2007. Pet. App. A, pp. 1a-50a. This Court granted Intervenors' unopposed Motion for an Extension of Time to File this Petition through October 31, 2007, on September 27, 2007. Pet. App. G, pp. 118a-119a. This Court has jurisdiction pursuant to 28 U.S.C. § 1254.

STATUTES OR OTHER PROVISIONS INVOLVED

Relevant portions of the Internal Revenue Code, 26 U.S.C. § 7525 (2001),[2] are reproduced at Pet. App. E, p. 112a-113a.

STATEMENT OF THE CASE

This case presents two important issues involving the application of privileges: the first relates to the need of every lawyer, law student, and now accountant to have a simple, consistent crime-fraud rule at their fingertips, while the second focuses on whether titles contemporaneously enacted by Congress as part of the statute as a whole constitute part of the law.

The case arises from a civil tax examination of an accounting firm, BDO Seidman, L.L.P., with respect to the applicability of certain preparer and/or promoter penalties. Incident to that examination, the IRS summonsed a large volume of client records from 2001 and prior periods. A group of those clients intervened and took a restrained view, asserting privileges (Section 7525 Tax Practitioner Privilege, attorney-client privilege, and work product protection) as to only 267 of the thousands of their summonsed documents.

After an *in camera* review, the District Court held that 266 of the 267 documents were covered by one or

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[2] Unless indicated otherwise, all Section references are to Title 26 of the United States Code – that is, the Internal Revenue Code of 1986 (as amended through December 31, 2001).

more of the privileges. Further, the Court held that Document A-40 constituted evidence of some [unidentified] crime or fraud, and thus, was not entitled to protection. That document (which has since been produced pursuant to Court order and is reproduced at Pet. App. F, pp. 114a-117a) is an email exchange between two tax practitioners at the accounting firm. It explicitly refers to this Court's opinion in *Cottage Sav. Ass'n v. Commissioner*, 499 U.S. 554 (1991) with respect to obtaining desired tax benefits from distressed debt investments prior to year-end.[3]

In classifying A-40, the District Court initially relied upon factors from the trial opinion in *Denney v. Jenkins & Gilchrist*, 340 F. Supp. 2d 338 (S.D.N.Y. 2004), *rev'd. in part, vacated in part*, 412 F.3d 58 (2d Cir. 2005):[4]

> (1) the marketing of pre-packaged transactions by BDO; (2) the communication by the Intervenors to BDO with the purpose of engaging in a prearranged transaction

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[3] *Cottage Savings* was a case in which a taxpayer exchanged one bundle of distressed mortgages for another. This Court held that the exchange properly resulted in the recognition of the desired tax losses.

[4] The trial court also cited two other cases as a source for these factors, *Miron v. BDO Seidman, L.L.P.*, 342 F.Supp.2d 324 (E.D. Pa. 2004), and *United States v. KPMG, L.L.P.*, 316 F.Supp.2d 30 (D.D.C. 2004). However, *Miron* concluded that the crime-fraud exception did not apply to the generalized scope of the BDO consulting agreement and the *KPMG* Court never discussed the exception.

> developed by BDO or [a] third party with the sole purpose of reducing taxable income; (3) BDO and/or the Intervenors attempting to conceal the true nature of the transaction; (4) knowledge by BDO, or a situation where BDO should have known, that the Intervenors lacked a legitimate business purpose for entering into the transaction; (5) vaguely worded consulting agreements; (6) failure by BDO to provide services under the consulting agreement yet receipt of payment; (7) mention of the COBRA transaction; and (8) use of boiler-plate documents.

Denney was not a tax case, nor one involving the assertion of a privilege, but rather a dispute between clients and their tax advisors over the enforceability of an arbitration clause in a consulting agreement. That Court relied on these factors to draw the conclusion of mutual fraud (as to the generalized scope of the agreement) and thereby refused to enforce the arbitration clause. No federal court had previously identified this list as evidence of wrongdoing (let alone fraud or some crime) or relied on it for the application of a privilege.

Here, the District Court pointed to the reference in A-40 relating to closing the *Cottage Savings* swaps by year-end to reap desired tax benefits. Without identifying the "crime or fraud" or any of the elements that A-40 somehow evidenced, the Court directed the Intervenors to offer an explanation. In response, the Intervenors submitted declarations from the BDO personnel involved, attesting to their business reasons for sending the email, as well as materials confirming

the accepted practice of closing out positions by year-end to reap desired tax benefits. Counsel for the IRS then tendered a supplemental affidavit echoing the *Denney* factors. That declaration never identified a crime or fraud, certainly never offered evidence as to the essential elements of that [unidentified] crime or fraud, and drew no correlation between the *Denney* contentions and A-40. The exhibits the IRS attached to the declarations included a statement by the distressed debt trader that it was pursuing an investment that "will yield very good profits for investors." Another exhibit consisted of an email relaying the statement by the trader that certain debt includes a "kicker" with "a bonus payoff of probably around 12-1." The District Court reviewed these materials, concluded that the documents as a whole reflected an intent to reap a profit, but upheld its prior ruling.

Shortly thereafter, the Second Circuit reversed the *Denney* fraud holding, thereby undercutting the factors relied upon by the District Court. The Intervenors promptly filed a motion for reconsideration based on the reversal. Citing the same "totality of the circumstances" conclusion that preceded the *Denney* reversal, the District Court stated that it used the *Denney* factors only as "guidelines" and upheld its ruling that A-40 somehow evidenced a (still unidentified) crime or fraud.

The Intervenors appealed and asserted that the District Court erred in failing to require the party asserting the crime-fraud exception to make a *prima facie* showing that distinguished between fraud and non-fraud by identifying the alleged crime-fraud and

producing *prima facie* evidence as to its essential elements. In its opinion, the Seventh Circuit recognized a conflict with other Circuits but, based on its precedent, held that no crime-fraud need be identified nor evidence offered as to the essential elements of the [unidentified] charge.

The second issue, the construction of the Section 7525(b) "corporate tax shelter" exception to the privilege, invokes the broader question relating to the standing of titles contemporaneously enacted by Congress as part of the statute as a whole. Section 7525(a) extends the common law attorney-client privilege to cover the tax advice given by tax practitioners to taxpayers. Section 7525(b) excludes what its title describes as "communications regarding corporate tax shelters." The District Court concluded that the exception did not apply here. The Seventh Circuit reversed, on the grounds that the title must be disregarded unless the textual portion of the statute is ambiguous.

The Client/Intervenors submit that the title contemporaneously enacted by Congress must be considered as part of the statute as a whole, that coupled with the textual tie between "promotion" and "corporation" it reflects the plain meaning of this exception, and failing that, the conflicting meanings from the District Court and the Panel confirm the ambiguity that requires consideration of the title.

REASONS FOR GRANTING THE PETITION

Both issues reverberate beyond the four corners of this case and this statute.

A. THE CRIME-FRAUD CONFLICT CONFUSES WHAT SHOULD BE A SIMPLE CONSISTENT RULE AT THE FINGERTIPS OF EVERY LAWYER, LAW STUDENT, AND NOW ACCOUNTANT.

Every litigant in every hotly contested case or controversy is tempted to accuse his adversary of fraud or even a crime in the form of misrepresenting the disputed facts. The law of the D.C., Third, Fifth, Ninth, and Eleventh Circuits responsibly restrains such reckless slanders by insisting upon a genuine *prima facie* test that distinguishes between crime-fraud and the universe of other conduct – that is, accurate reliance on substantive Supreme Court authority (Document A-40), honest differences of opinion, mistake, or negligence. Reckless allegations by the federal government destroy lives without regard to the outcome. This Court witnessed the 26,000 innocent people who lost their jobs and retirement as a result of the reckless accusations in *United States v. Arthur Andersen & Co.*, 544 U.S. 696 (2005). Document A-40 captures that problem even more clearly. Imagine a relatively short email exchange between two tax practitioners which explicitly refers to a substantive Supreme Court opinion (*Cottage Savings)* to confirm desired tax benefits as somehow being twisted into *prima facie* evidence of a crime or fraud instead of an overt effort to follow the law. Yet, that is precisely what the District Court held and the

Seventh Circuit affirmed under what is here the spokeless umbrella of "totality of the circumstances."

Consistent with the Roman maxim that the law never presumes fraud, *prima facie* proof of crime-fraud should require (i) identification of the specific crime-fraud alleged and (ii) evidence as to the essential elements. Obviously, the absence of one of those essential elements distinguishes between what is and is not a crime or fraud. Only that approach comports with the precedent of this Court embedded in every Circuit's uniform set of jury instructions: decency demands that a crime-fraud allegation be distinguished from the universe of other conduct.[5]

More to the point here, this Court has long recognized that tax avoidance is a proper purpose. As Justice O'Connor stated on behalf of the Court in *United States v. Carlton,* 512 U.S. 26, 35-36 (1994):

> [I]t was entirely appropriate for Carlton to seek to reduce the estate taxes. And like all taxpayers, Carlton was entitled to structure the estate's affairs to comply with the tax laws while minimizing tax liability. As Learned Hand observed with characteristic acerbity: "[A] transaction, otherwise within an exception of the tax law, does not lose its immunity, because

[5] *See, e.g., Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 214 (1976) (recognizing the difference between negligent conduct and fraudulent conduct); *United States v. United States Gypsum Co.*, 438 U.S. 422, 445 (1978) (same); *United States v. Pechenik*, 236 F.2d 844, 846 (3d Cir. 1956) (fraud "does not include negligence, carelessness, misunderstanding or unintentional understatement of income").

> it is actuated by a desire to avoid, or, if one choose, to evade, taxation. Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes." *Helvering v. Gregory*, 69 F.2d 809, 810 (CA2 1934), *aff'd*, 293 U.S. 465 (1935).

A permitted purpose does not a crime or fraud make.

1. Every Lawyer, Every Law Student, and (Now) Every Accountant Needs the Same, Simple Crime-Fraud Rule at His Fingertips.

For purposes of protecting his or her integrity and reputation, every lawyer in the land ought to be able to instantly state the same simple crime-fraud rule – regardless of whether they practice in Washington, Chicago, San Francisco, New York, or Cut-N-Shoot, Texas. Indeed, every first year law student ought to be able to state the same simple crime-fraud rule that comports with every other use of the phrase "*prima facie* case" and ought to be able to do so regardless of whether they are at Loyola, Harvard, Stanford, Gonzaga, Emory, or some night law school. Now that Congress has followed the lead of 34 states in transporting the attorney/client privilege into the world of accounting, every accountant, return preparer, and enrolled agent in the land must be able to state the same simple crime-fraud rule in more concrete terms than the flash of "colour" and "totality of the circumstances" with no identified crime or fraud and no evidence of the essential elements. The present

conflict between the Circuits on this critical question obliterates the possibility of any lawyer, law student, or accountant accurately stating one simple rule – unless they live and practice exclusively in the D.C., Third, Fifth, Ninth, or Eleventh Circuits.

No one does. It is not just a matter facing every federal tax practitioner with clients who have retired to Florida, New Mexico, or southern California. Suppose a tax lawyer sitting in her office in Washington emails her partner in Dallas about a tax planning transaction based on substantive Supreme Court authority. So far, so good. Same simple rule applied, protecting her reputation and integrity by barring reckless crime-fraud allegations absent an identified crime or fraud and some evidence of the essential elements. But suppose the Dallas partner wants advice about some securities aspect and forwards the email to their partner in Chicago. With no identified crime or fraud and no evidence as to its essential elements, the reckless IRS allegation that this case invites in the Seventh Circuit destroys the lifelong reputation of the Washington tax lawyer.

2. No One Can Effectively Defend Himself or Herself Against a Crime-Fraud Accusation With No Identified Crime or Fraud and No Evidence of the Essential Elements.

Schoolyard justice demands that someone be told what he did wrong before he is forced to defend himself. Otherwise, he is shadowboxing with a vaporous accusation. The Constitution demands more. Our system of justice begins with the due process

requirement that a person be told what he did wrong, before he can be expected to explain why that act does not constitute a wrong or that he did not do it. Here, the accusation need not even rise to the level of unconstitutionally vague, for it need not be identified at all. No one can defend himself against unidentified wrongs, nor is anyone immune to overstated, vague, or reckless allegations impugning one's integrity.

The law recognizes that the mere allegation of crime or fraud can scar a decent man or woman for life. For that reason, the law requires heightened pleading and proof standards for civil fraud and criminal accusations. At a minimum, such accusations require that the crime or fraud be pled with specificity as to each essential element. Absent those elements, the conduct constitutes something other than a crime or fraud. The reality that the law imposes the burden of proof upon the accuser and sets the bar at the heightened level of "clear and convincing evidence" for civil fraud and "proof beyond a reasonable doubt" for crimes, conveys the sensitivity of a civilized society to the most corrosive form of slander.

The Seventh Circuit's standard could infect virtually every civil and criminal proceeding involving privileged communications. It begs the question of what crime or fraud is charged. Essentially, it leaves the District Court with the burden, if not the caprice, of applying an *ipse dixit* standard with no need to identify anything more than suspicions about unidentified wrongs. As such, courts will invariably vitiate valid privileges and malign people in situations involving nothing more than a factual dispute, competing evidence, or just negligence, as

distinguished from a true crime or fraud which should never be presumed. The litigant protecting the privilege there, as here, must aim in the dark at a constantly moving target.

This case essentially paints the parties involved – BDO and the Clients – with a brush that retroactively presumes they must be wrongdoers. At most, the IRS and, at points, the District Court, seemed to equate the IRS' self-serving "abusive tax shelter" label[6] with some kind of unspecified crime or fraud. The problem exceeds the reality that this label and the application of the Supreme Court authority remain a hotly contested dispute and that such debatable matters are not the stuff of crimes or frauds. *See, e.g., United States v. Critzer*, 498 F.2d 1160, 1163 (4th Cir. 1974) ("pioneering interpretations of the tax law should not be sought or rendered in criminal prosecution"); *United States v. Dahlstrom*, 713 F.2d 1423, 1428 (9th Cir. 1983). The problem, however, is far greater.

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[6] That pejorative is itself abused for at least two reasons. One, the phrase "tax shelter" statutorily includes any arrangement with a significant tax avoidance purpose (Section 6662(d)(2)(C)). That point covers virtually every business, investment, homeowner, divorce, and estate planning decision. *See, e.g., D'Arcy-MacManius & Masius, Inc. v. Commissioner*, 63 T.C. 451 (1975) ("consideration of tax aspects . . . is only prudent business planning"); *Brumley-Donaldson Co. v. Commissioner*, 443 F.2d 501, 510 (9th Cir. 1971) (Trask, J., dissenting) ("In the complexity of today's business and tax jungle a corporate president who does not obtain tax advice . . . ought to be fired"). Two, the IRS applies the "abusive" pejorative retroactively to these 2001 distressed debt investments (the subject of A-40) on an *ex post facto* basis via a position the IRS first published six years later *in 2007*. IRS LMSB-04-0407-031 (April 18, 2007).

The IRS asserted the exact same label before this Court in *Cottage Savings* with no suggestion of even negligence, and this Court confirmed that the taxpayer *accurately* recognized the distressed debt loss. In *United Parcel Serv. of Am. v. Commissioner*, 254 F.3d 1014 (11th Cir. 2001), the IRS again leveled the same pejorative with the contention that the company lacked any non-tax purpose and the contention that the company was negligent – not fraudulent and certainly not criminal. The IRS persuaded the trial court that the company was both wrong and negligent. A three-judge panel found, however, that the so-called "abusive tax shelter" position taken by the company was technically sound and ACCURATE. The exact same sequence arose in *Compaq Computer Corp. v. Commissioner*, 277 F.3d 778 (5th Cir. 2001), and *IES Indus., Inc. v. Commissioner*, 253 F.3d 350 (8th Cir. 2001). The trial courts in both of those cases sustained the IRS' "abusive tax shelter" contention that the taxpayers were both wrong and negligent (with no suggestion of fraud or criminal conduct), and two separate three-judge appellate panels determined that the companies' positions not only fell short of negligence – they were CORRECT.[7] How in God's green earth can there be a crime or fraud when the as yet untested position may well be accurate?

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[7] The whiplash between one judge finding a given transaction wrong *and* negligent while a three-judge panel finds that same tax treatment technically sound is not lost on the commentators. *See Courts Can't Agree On When Negligence Penalty Applies*, 84 J. Tax'n 191 (March 1996); *Courts Still Can't Agree on When Negligence Penalty Applies*, 90 J. Tax'n 377 (June 1999).

3. The Conflict Confuses What Should Be a Daily Commandment.

Not quite 75 years have passed since this Court squarely addressed the crime-fraud exception, and then it was in a juror-privilege context. *Clark v. United States*, 289 U.S. 1, 15 (1933). Aspects of the exception were raised in 1989 but, while the Court offered some observations, it concluded that it need not decide the quantum of proof required to establish the exception. *United States v. Zolin*, 491 U.S. 554, 563 (1989).[8] By our count, four branches sprouted from the broad language in *Clark*, though only one departs from the reality that this Court identified a specific crime or fraud and ample evidence of its *prima facie* elements – just as every other court has in every case except this one.

In *Clark*, the Supreme Court addressed whether a crime-fraud exception applied to the common law privilege protecting juror deliberations. The prosecution specifically alleged that a juror both obstructed justice and committed perjury. *Id.* at 9. In concluding that the crime-fraud exception applies to juror deliberations, the Court looked to the exception to attorney-client communications. This Court rejected earlier cases that seemed to waive the attorney-client privilege based solely on "a mere charge of illegality, not supported by any evidence. . .", instead holding:

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[8] *Zolin* dealt with the District Court's discretion in refusing to review certain audio tapes *in camera* which this Court confirmed involves a lower standard than proof of the crime-fraud exception.

> It is obvious that it would be absurd to say that the privilege could be got rid of merely by making a charge of fraud... To drive the privilege away, there must be "something to give colour to the charge"; "*prima facie*" evidence that it has some foundation in fact.

Clark, at 15. The Court pointed to ample evidence of the elements of the crime:

> In the record now before us the evidence of guilt is ample, without the happenings in the jury room, to break down the claim of privilege, and thus let in the light. There is the evidence of the concealment of the petitioner's employment with all its sinister implications. There is evidence of her arguments with the jurors while the trial was going on. There is even the evidence of her vote, for the fact that she voted for acquittal had been stated in her answer, and to the extent of the voluntary disclosure, the privilege had been waived.

Id. at 18. Thus, the holding stands on the foundation of an identified crime (obstruction) and ample independent evidence, outside of the privileged communications, establishing the essential elements of that identified crime.

Without recognizing the presence of the identified crime and ample evidence of its essential elements in *Clark*, the Seventh Circuit took the general phrases in the 1933 *Clark* opinion to a dangerous extreme:

> BDO and the Intervenors would require the party seeking to abrogate the attorney-client privilege to make out a prima facie case of each element of a particular crime or common law fraud to invoke the crime-fraud exception. Such a burden is inconsistent with our requirement that the party seeking to abrogate the privilege need only "give colour to the charge" by showing "some foundation in fact." *Al-Shahin*, 474 F.3d at 946 (quoting *Clark*, 289 U.S. at 15, 53 S.Ct. 465) (internal quotation marks omitted). The approach advocated by BDO and the Intervenors reflects the view of some circuits, which require enough evidence of crime or fraud to support a verdict in order to invoke the crime-fraud exception. *See In re Feldberg*, 862 F.2d 622, 625 (7th Cir. 1988). We expressly have rejected that approach.

BDO Seidman, at 818-19. The Panel's approach frankly invites reckless allegations, responsibly restrained by the construction that most Circuits apply to the *Clark* concepts.

The best stated rule – and the rule embraced by more Circuits than any other – (i) cures the danger raised by standards that fail to distinguish between fraud and non-fraud, and (ii) comports with the traditional understanding of a *prima facie* case throughout the law. The standard followed by the D.C., Third, Fifth, Ninth, and Eleventh Circuits requires evidence of the elements of the (identified) violation.

In the Court of Appeals case most commonly cited by other circuits, the D.C. Circuit defined *prima facie* evidence of the crime-fraud exception as requiring that the party seeking to circumvent the privilege must:

> . . . [proffer] evidence that if believed by the trier of fact, would establish the elements of some violation that was ongoing or about to be committed.

In re Sealed Case, 676 F.2d 793, 815 (D.C. Cir. 1983). *See also, In re Sealed Case*, 107 F.3d 46, 50 (D.C. Cir. 1997) (same holding). In both cases, the Government alleged a specific crime and presented independent evidence of its essential elements. For example, the government in the 1983 case pointed to 18 U.S.C. § 371 and produced affidavits by company employees about payments to government officials.

Similarly, the Third Circuit follows the same path, after attempting to reconcile the competing views into this one straightforward test:

> [B]ased on its [district court's] analysis of the various standards applied by the courts of appeals, the district court concluded that "all of these proposed standards amount to the same basic proposition – has the party seeking discovery presented evidence which, if believed by the fact-finder, supports plaintiff's theory of fraud?"... We interpret this statement to mean that *the party seeking discovery must present evidence which, if believed by the fact-finder, would be sufficient to support a finding that the elements of the crime-fraud exception were met.*

Haines v. Liggett Group Inc., 975 F.2d 81, 95-6 (3d Cir. 1992) (emphasis added). *See also, In re Grand Jury Investigation*, 445 F.3d 266, 274 (3d Cir. 2006). While consistent with the majority of the other Circuits, requiring *prima facie* proof of the elements clearly conflicts with the Seventh Circuit dismissing that need here.

The Fifth Circuit also responsibly restrains reckless allegations by requiring the universally understood *prima facie* standard:

> To make the necessary prima facie showing for the application of the crime-fraud exception here, the government must produce evidence "such as will suffice until contradicted and overcome by other evidence... a case which has proceeded upon sufficient proof to that stage where it will support [a] finding if evidence to the contrary is disregarded."

In re Grand Jury Subpoena, 419 F.3d 329, 336 (5th Cir. 2005), *quoting In re Intl. Sys. Controls Corp. Sec. Litig.*, 693 F.2d 1235, 1242 (5th Cir. 1982) (finding that "ambiguous and controverted" evidence offered by the government failed to establish a *prima facie* case of fraud).[9]

So too, the Ninth Circuit defines "prima facie evidence" consistent with the traditional understanding of that phrase ("The government must submit 'evidence that if believed by a jury, would

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[9] *In Re Grand Jury Subpoena* involved specific allegations of perjury and obstruction of justice.

establish the elements of an ongoing violation'"). *United States v. Chen*, 99 F.3d 1495, 1503 (9th Cir. 1996), *quoting United States v. Laurins*, 857 F.2d 529, 541 (9th Cir. 1988). In both *Chen* and *Laurins*, the Court specifically identified the crime or fraud and pointed to independent evidence of their elements. In *Laurins*, for example, the government specifically identified the crime as obstruction of justice through the target's withholding documents that the Court ordered produced and the government produced those very (allegedly non-existent) documents from a seizure at the defendant's home. *Id.* at 534-35.

The Eleventh Circuit test for invoking the crime-fraud exception mirrors that of the D.C., Third, Fifth, and Ninth Circuits in that, a party invoking the crime-fraud exception to the attorney-client privilege must show:

> evidence that, if believed by a trier of fact, would establish the elements of some violation that was ongoing or about to be committed.

In re Grand Jury Investigation, 842 F.2d 1223, 1226 (11th Cir. 1987). As with the other circuits, a specific crime or fraud was asserted against the client (there, tax evasion), and the District Court relied on independent evidence, other than mere allegations, that the client used communications with his attorney to perpetrate that crime. *Id.* at 1227. The evidence included admissions the client made about his income, an IRS summary reflecting assets well above reported income, purchase of a home at 10 times reported income, and payment of that purchase price in cash.

On a slightly different branch, the Fourth and Eighth Circuits both require a *prima facie* showing of crime-fraud but do not explicitly address the need for evidence as to the essential elements. *Compare In re Grand Jury Proceedings, Thursday Special Grand Jury Sept. Term, 1991,* 33 F.3d 342, 352 (4th Cir. 1994), and *In re Berkley and Co., Inc.,* 629 F.2d 548, 553 (8th Cir. 1980).

A third line of opinions comes from the First, Second, and Sixth Circuits, along with a variation on the Ninth Circuit precedent. They state different standards for the *weight* of the evidence required to establish a *prima facie* case of crime-fraud. Any discussion of the weight of the required crime-fraud evidence necessarily assumes that, whatever the required weight may be, it establishes the essential elements of the violation. In every instance, the courts specifically identify the crime or fraud and only apply the exception where ample independent evidence exists as to the essential elements. Hence, the *weight* cases bolster the D.C., Third, Fifth, Ninth, and Eleventh Circuits' precedent requiring "evidence, if believed by a trier of fact, would establish the elements of an ongoing or imminent [identified] crime or fraud." *In re Sealed Case*, 107 F.3d at 50. The Ninth Circuit draws a distinction between the *weight* required in civil cases like this and criminal cases. In its recent opinion on the subject, *In re Napster, Inc. Copyright Litigation*, 479 F.3d 1078, 1094-95 (9th Cir. 2007), the Ninth Circuit held:

> [W]e conclude that in a civil case the burden of proof that must be carried by a party seeking outright disclosure of attorney-client

> communications under the crime-fraud exception should be preponderance of the evidence.

Accord: Medical Lab. Mgmt. Consultants v. Am. Broad. Cos., Inc., 30 F.Supp.2d 1182, 1206 (D. Ariz. 1998) ("district court must determine, by a preponderance of the evidence, whether the exception is justified"); *In re Omnicom Group, Inc. Sec. Litig.*, No. 02CIV4483, 2007 WL 2376170 (S.D.N.Y. Aug. 10, 2007) (adopting the *Napster* preponderance of the evidence standard for civil litigation).

The varying First, Second, and Sixth Circuit opinions further underscore the need for clarification by this Court in that – at least in criminal cases – they prescribe the required weight as reasonable belief, reasonable cause, or probable cause. *See In re Grand Jury Proceedings*, 417 F.3d 18, 23 (1st Cir. 2005) ("reasonable basis . . . something less than a mathematical (more likely than not) probability that the client intended to use the attorney in furtherance of a crime or fraud . . . In all events, the reasonable cause standard is intended to be reasonably demanding . . ."); *In re Grand Jury Subpoena Duces Tecum Dated Sept. 15, 1983*, 731 F.2d 1032, 1039 (2d Cir. 1984) (Identifies crime as 18 U.S.C. § 1503 violation and equates "reasonable basis," "reasonable cause," and "probable cause"); *In re Richard Roe, Inc.*, 68 F.3d 38, 40 (2d Cir. 1995) ("probable cause"); *United States v. Collis*, 128 F.3d 313, 321 (6th Cir. 1997) ("a prudent person would have a reasonable basis to suspect the perpetration of a crime or fraud"); *In re Antitrust Grand Jury*, 805 F.2d 155, 164 (6th Cir. 1986).

The Sixth Circuit precedent, like the Seventh Circuit opinions, reflects internal conflicts and thereby underscores the confusion in this critical area. For example, the Sixth Circuit in *Collis* endorses "a reasonable basis to *suspect*," while its *In re Antitrust Grand Jury* opinion holds that "[t]he evidence produced by the government must raise more than a strong suspicion that a crime was committed to establish a prima facie violation". *In re Antitrust Grand Jury*, at 165.

The Seventh Circuit follows what this case proves to be the spokeless umbrella of "totality of the circumstances" so long as the party opposed to the privilege "gives colour to the [unidentified] charge" by showing "some foundation in fact." *BDO*, 492 F.3d at 818. That umbrella conveys no meaning, much less distinguishes between crime-fraud on the one hand and even honest differences of opinion on the other. Consider the unconstitutional vagueness of a "*prima facie* crime-fraud" test that (i) requires no identified crime or fraud AND (ii) requires no evidence of the essential elements – the same essential elements that, in every other context, the law demands heightened specificity in pleading and heightened standards of proof before scarring someone for life.

To be sure, the earlier Seventh Circuit cases cited by the Panel here state a permissive standard but do so in the context of clearly identifying both a crime or fraud and ample independent evidence of their essential elements. For example, the Seventh Circuit seems to rely most heavily upon its opinion in *United States v. Al-Shahin*, 474 F.3d 941, 946-7 (7th Cir. 2007) where the Court stated the standard as:

> [A]ll that is needed is something to give color to the charge that the Al-Shahins engaged in a fraudulent scheme to obtain money from a staged accident from an insurance company, culminating in mail fraud.

The *Al-Shahin* panel, however, took pains to cite the extensive independent evidence of the identified mail fraud, including the accident occurred on the most common night for staged accidents; the purported driver and passenger of the other vehicle admitted that the accident was staged; the type of injuries inflicted on the Al-Shahins were typical staged accident injuries (soft tissue); and the Al-Shahins signed in 21 times to a clinic but only received treatment a few times. The Court found this "circumstantial evidence" constituted a *prima facie* case that the Al-Shahins consulted with their attorney on their (mail fraud) claims. *Id.* at 947.

The Seventh Circuit in this case also cited its earlier opinion, *In the Matter of Feldberg,* 862 F.2d 622, 625-26 (7th Cir. 1989), which undeniably states the permissive standard of "[t]he question is not whether the evidence supports a verdict but whether it calls for an inquiry." Again however, the Seventh Circuit took pains in *Feldberg* to specifically identify the crime as obstruction of justice and to point to ample independent evidence of the essential elements – evidence that the defendant's lawyer originally produced 51 contracts as a complete production in response to a grand jury subpoena and later produced seven "post-dated" contracts. *See also, In re Special September 1978 Grand Jury*, 640 F.2d 49, 54 (7th Cir. 1980) (Court cited specific state statute violated by

false election reports filed by defendant's law firm, noted that the government both submitted the false reports and pointed out their falsity as independent evidence of the crime). Thus, the courts in each of those cases felt it necessary to identify the kind of specificity sought by the Intervenors, regardless of the enunciation of the standard. Nonetheless, the imprecise standard remains the rule in that Circuit.

4. Explicit Reliance on Substantive Supreme Court Authority on the Face of A-40 Demonstrates the Danger of Reckless Crime-Fraud Allegations.

No case better demonstrates the amorphous, unpredictable, and therefore dangerous nature of the umbrella "totality of the circumstances" than the awkward situation faced by the District Court in this case. At the time the District Court concluded that Document A-40 rose to the level of *prima facie* crime-fraud, it relied on the eight factors the IRS extracted virtually verbatim from the arbitration clause dispute in the non-tax trial court opinion in *Denney*.

The *Denney* factors never distinguished between crime-fraud and accurate reliance on Supreme Court authority, honest differences of opinion, mistake, negligence, or recklessness, but the District Court listed no other factors here. Perhaps recognizing that these factors fail to distinguish between fraud and the universe of non-fraud, the District Court correctly concluded that these global factors did not push the overall BDO tax planning efforts across the line into the realm of crime-fraud. Pet. App. D, p. 83a. Thus, the Intervenors faced no identified crime-fraud, no

evidence as to the unidentified essential elements, and eight factors that failed to distinguish between fraud and permitted purposes.

Without identifying the specific crime-fraud, or the *prima facie* elements, the District Court requested a rebuttal from the Client/Intervenors. The documents reviewed *in camera* confirmed an interest in reaping profits, as the Court confirmed. The Client/Intervenors, therefore, inferred that the Court's concern related to the year-end tax avoidance considerations. On that score, the trial court's solely-tax-motivated finding in *Cottage Savings*, the case noted on the face of A-40, confirms that even the *sole* purpose of tax avoidance (as opposed to the dual profit and tax purpose here) does not negate the deducibility of losses recognized from distressed debt.[10] *Cottage Savings*, 90 T.C. at 384. Given the *in camera* evidence of their profit motive and the *Cottage Savings* confirmation as to the permissible tax purposes, the Client/Intervenors responded to the District Court's request with evidence of the accepted tax planning practice of triggering tax losses at the end of the year. The IRS then tendered its fifth supplemental affidavit: it attached at least two documents that further confirmed that certain distressed debt investments in particular "will yield very good profits for investors"[11]

[10] Distressed debt is peculiar in that, when contributed to a partnership, it carries the ability to generate unused built-in tax losses *and* substantial profits from the incremental increase in the value of the debt/receivables.

[11] The District Court later cited this email which both notes this interest in profitability and the BDO tax practitioners' focus upon compliance with a particular tax rule that potentially impacted

and another bundle offered "a bonus payoff of probably 12-1." Nonetheless, the Court concluded that the explanation by the Intervenors was insufficient for reasons the Client/Intervenors still cannot clearly identify – beyond the eight *Denney* factors under the "totality of the circumstances" umbrella.

Shortly thereafter, the Second Circuit broke the spokes of that umbrella by reversing *Denney*. To be sure, the Second Circuit reversed on the stated grounds that no admission as to mutual fraud existed, but that finding of no fraud necessarily meant that the eight factors failed to establish fraud. Otherwise, the District Court's opinion would have been affirmed on that point. The Client/Intervenors promptly asked the District Court in this case to reconsider its prior ruling in light of the *Denney* reversal. From the Intervenors' perspective, the response was enigmatic. The District Court denied the Motion for Reconsideration on the assertion that it used the *Denney* factors only as "guidelines" and considered the "totality of the circumstances." No one can say what factors the District Court considered in support of the still unidentified crime or fraud – other than the tainted *Denney* factors.

All of this shadowboxing highlights the breadth and depth of the danger raised in all cases by the "totality of the circumstances" abdication of standards. Only

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the tax aspect of these tax-advantaged investments upon which the tax practitioners were focused.

caprice dictates the incredibly corrosive crime-fraud scar where:

(i) No crime-fraud need be identified,

(ii) No evidence need exist as to the unidentified essential elements beyond the flash of "colour to the [unidentified] charge" and some unspecified "foundation in fact" for the unidentified crime-fraud, and

(iii) The genesis of the eight factors can be stricken by a reversal.

For the foregoing reasons, this Court should accept this Petition and resolve the disagreements between the Courts of Appeal about the proper standard.

B. THE CONFLICT BETWEEN THOSE CASES THAT READ A STATUTE AS A WHOLE AND THOSE THAT IGNORE THE TITLE CONTEMPORANEOUSLY ENACTED BY CONGRESS CREATES CONFUSION OVER THIS COURT'S "HOLISTIC ENDEAVOR."

The second issue, the construction of Section 7525(b), also concentrates on a conflict that goes well beyond this statute and this case. Sooner or later, courts must construe every statute. Those statutes now carry Congressionally enacted titles. Today, a confusion exists as to whether titles contemporaneously enacted by Congress constitute part of the law.

Every day, people must read and understand these statutes – with the titles that define their subject matter and scope. Far too often, the beacon of "plain meaning" simply restates the question and only cosmetically alters the lines of attack. The Seventh Circuit conflict demonstrates the dangers of casting aside the canon of reading a statute as a whole in favor of disregarding the title – not to mention a nation that cannot say which words enacted by Congress constitute law.

While some statutes from decades past contained titles added by an outside publisher, every modern federal statute contains titles enacted by Congress as part of the whole, titles designed to convey direction, meaning, and context to the reader. Those voting on the statute, those subjected to or benefited by that statute, and those who later read that statute glean at least equal meaning from the overall description Congress chose to enact. In every instance of the written word, titles convey the subject matter and scope of what follows.

In the typical statutory construction case where both sides (and here, two courts in the same case) contend that the text carries a plain (but opposite) meaning, the Seventh Circuit acknowledges that the title conveys the meaning urged by the Client/Intervenors of what should be the narrowly construed Section 7525(b) "corporate tax shelter" exception to the (remedial and therefore broadly read) Tax Practitioner Privilege. Congress not only contemporaneously enacted that title as part of the original statute as a whole, it later affirmatively amended that title (and the text) to apply to individual

tax shelters – and explicitly mandated *prospective* application of that amendment. Nonetheless, the Seventh Circuit explicitly disregards that title based on the Panel's conclusion that the text conveys a plain meaning that covers both individual tax shelters and corporate tax shelters.

1. The Panel's Ruling Results From a Tension in this Court's Precedent that Needs to Be Resolved.

Disregarding the contemporaneously enacted title as part of the statute as a whole defies this Court's confirmation in *Koons Buick Pontiac GMC, Inc. v. Nigh*, 543 U.S. 50, 59 (2004) that "[S]tatutory construction is a 'holistic endeavor . . . .'" *Id.*, *quoting United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 371 (1988). *See also, TRW Inc. v. Andrews*, 534 U.S. 19, 31 (2001) ("it is a cardinal principle of statutory construction that 'a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant'"). In their concurring opinion in *Koons*, Justices Stevens and Breyer expanded on the Majority's "holistic endeavor" by noting (with respect to legislative history) the important principle that:

> It would be wiser to acknowledge that it is always appropriate to consider all available evidence of Congress' true intent when interpreting its work product. *Koons*, 543 U.S. at 65-66.

Both the "holistic endeavor" embraced by the *Koons* Majority and the "all available evidence of Congress' true intent" embraced by the Concurring Opinion weigh against turning a blind eye to the entire statute enacted by Congress. The Panel disregards the contemporaneously enacted title based on a quote by a 1998 Supreme Court opinion to a 1947 Supreme Court opinion. *BDO*, 492 F.3d at 823, *quoting Penn. Dept. of Corr. v. Yeskey*, 524 U.S. 206, 212 (1998), *quoting Bhd. of R.R. Trainmen v. Baltimore & Ohio R.R. Co.*, 331 U.S. 519, 528-29 (1947). That quote, however, flows from the days when publishers often injected titles never enacted by Congress.

Time obscures whether the title disregarded by *Trainmen* was injected into the 1887 Interstate Commerce Act by a publisher or enactment. What is clear is that the 1887 heading was not contemporaneously enacted as part of the subject 1940 amendment. Moreover, the Court resolved the question by resort to the (1940) legislative history, and the holding comports with reading the statute (including the amendments) as a whole, all of which favors recognition of the Section 7525(b) title.

Moreover, the Seventh Circuit proceeds on a doubly flawed premise. One, its reading of Section 7525 disregards the inconsistent "plain meaning" derived by the District Court and ignores the textual requirement that the communication with the corporation be made "in connection *with the promotion* of the direct or indirect participation *of such corporation* in any tax shelter . . . ." In short, the title simply corroborates the textual requirement that the corporation is the subject of the tax shelter promotion – either directly or, like

the then-pending cases, by sheltering corporate tax indirectly through partnerships. Two, the reality that the District Court and the Panel reached inconsistent "plain meanings" confirms that the statute is susceptible to two or more readings – the essence of an ambiguity.

2. The Uncertain Standing of Contemporaneously Enacted Titles Leads to a Conflict Among the Circuits.

The D.C. and Fifth Circuits recognize that a title contemporaneously enacted as part of the original statute conveys real meaning as to the Congressional intent. *Hardin v. City Title & Escrow Co.*, 797 F.2d 1037, 1039 (D.C. Cir. 1986); *House v. Commissioner,* 453 F.2d 982, 987-988 (5th Cir. 1972). In *Hardin*, the D.C. Circuit emphasizes that "the description of the legislation was not added by a publisher or a codifier, but it was a part of the Act as written by Congress and therefore constitutes an indication of Congressional intent." *Hardin,* 453 F.2d at 1039. Similarly, the Fifth Circuit in *House*, after concluding that "there is nothing vague or confusing in such language," notes that "It is permissible in order to solve such difficulties, and in the pursuit of legislative intent, to take into consideration, not only the title to the act, but likewise the headings of the section if they are incorporated in the act, which as we have said, is the situation here." *House,* 453 F.2d at 985, 988 (citations omitted).

By contrast, the Ninth and Tenth Circuits maintain that even titles contemporaneously enacted by Congress as part of the statute are NOT part of the

law itself and cannot be considered absent textual ambiguity. *Singh v. Gonzales*, 499 F.3d 969, 975 (9th Cir. 2007); *Griffin v. Steeltek, Inc.*, 160 F.3d 591, 594 (10th Cir. 1998). In *Singh*, the Ninth Circuit relied in part on the title in resolving "'doubt about the meaning of [the] statute,'" but stated that "statutory titles are not part of the legislation." *Singh*, 499 F.3d at 977 (citation omitted). In *Griffin*, the Tenth Circuit reversed a summary judgment on the grounds that the title of the overall act (as opposed to the title of a specific exception), "Americans *with* Disabilities," was not part of the statute and did not limit claims to disabled persons.

3. The Section 7525(b) Corporate Tax Shelter Exception Only Applied to Communications Involving Arrangements Designed to Shelter *Corporate Tax*.

Never before has this Court addressed any aspect of Section 7525, which applies attorney-client privilege principles to "Federally Authorized Tax Practitioners." It is a relief provision that encourages candid and accurate communications between citizens and their tax advisors. As a relief provision, Section 7525 should be broadly construed. *Atcheson, Topeka and Santa Fe Ry. Co. v. Buell*, 480 U.S. 557, 582 (1987). Section 7525(a) provides:

> (a) UNIFORM APPLICATION TO TAXPAYER COMMUNICATIONS WITH FEDERALLY AUTHORIZED PRACTITIONERS. –

> (1) GENERAL RULE. – With respect to tax advice, the same common law protections of confidentiality which apply to a communication between a taxpayer and an attorney shall also apply to a communication between a taxpayer and any federally authorized tax practitioner to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney.

This case involves the Seventh Circuit's interpretation of the original version of the exception to Section 7525(a) found in subsection (b).

On its face, Section 7525(b) excludes corporate tax shelter communications from the federally authorized tax practitioner privilege:

> (b) SECTION NOT TO APPLY TO COMMUNICATIONS REGARDING CORPORATE TAX SHELTERS. – The privilege under subsection (a) shall not apply to any written communication between a federally authorized tax practitioner and a director, shareholder, officer, or employee, agent, or representative of a corporation in connection with the promotion of the direct or indirect participation of such corporation in any tax shelter (as defined in Section 6662(d)(2)(C)(iii)).

Both together and apart, the title and text of Section 7525(b) convey a cogent exception that does not consume the rule. The statute as a whole focuses precisely upon "corporate tax shelters" – that is,

arrangements that shelter corporate tax (not individual tax) and that were percolating their way through the courts at the time Congress enacted Section 7525. *See, e.g., IES* (summary judgment September 22, 1995); *UPS* (trial concluded November 7, 1997); *Compaq* (trial concluded September 29, 1998); and *ACM P'ship v. Commissioner,* 157 F.3d 231 (3d Cir. 1998) (corporate tax sheltered through partnership). So too, the text conveyed that purpose as a number of commentators confirm.[12]

Nonetheless, the Panel ignored the title and the textual tie between "promotion" and "corporation," in holding that the corporate tax shelter exception unambiguously applied to individual tax shelters so long as the arrangement directly or indirectly involves participation by any type of corporation (even S corporations that pay no corporate tax). *BDO*, 492 F.3d

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[12] Commentators and the Section 7525 privilege itself confirm the plain meaning of the "corporate tax shelter" exception. As noted by Louis F. Lobenhofer in *The New Tax Practitioner Privilege: Limited Privilege and Significant Disruption* TAX NOTES TODAY, 1999 TNT 113-93 (Jun. 11, 1999), the corporate tax shelter exception comes into play only with respect to "written communications with corporate representatives, ***so, oral discussions and proposals to individuals and unincorporated organizations" are still privileged***. *See also,* Calvin Johnson, *Corporate Tax Shelters, 1997 and 1998*, TAX NOTES TODAY, 98 TNT 187-84 (Sept. 28, 1998). ("... the section starts off with what might seem an important privilege, but then takes back the privilege when the client is a *corporation*"); Robert T. Smith, *After the Alamo: Taxpayer Claims of Privilege and the IRS War on Shelters*, TAX NOTES TODAY, 2003 TNT 9-47 (Jan. 13, 2003) ("[N]o protection applies under section 7525 for communications related to tax shelters by corporations").

at 823. That reading subsumes the universe of commerce, for every transaction involves the participation of a corporation in one capacity or another – be it the bank, the overnight delivery company, the real estate company, the brokerage firm, the printer, the law firm, the accounting firm, *ad infinitum*. All agree that the exception applies to arrangements that shelter *corporate tax* but the Panel also includes *individual* shelters that happen to involve a corporation in some way and excludes those that do not. Neither Congress nor anyone else ever pointed to a rational basis for including some individual shelters and excluding others.The Seventh Circuit notes that "[a]though the section heading suggests that Congress had corporate tax shelters in mind, 'the fact that a statute can be applied in situations not expressly anticipated by Congress demonstrates breadth, not ambiguity." *Id.* at 823, *citing Yeskey*, 524 U.S. at 212.

That reasoning necessarily concedes that the title contemporaneously enacted by Congress leads to the true Congressional intent.

4. The 2004 *Prospective* Amendments Prove the Original Congressional Intent.

When Congress later broadened Section 7525(b) prospectively, it proved that Congress meant what it said in 1998. In 2002, Congress considered expanding the Section 7525(b) exception to cover all tax shelters, as described in S. Rep. No. 107-211, at 79 (2002):

> ***The Committee believes that the rule currently applicable to corporate tax shelters*** should be applied to all tax shelters, regardless of whether or not ***the*** participant is a corporation. (Emphasis added).

Again in 2003, long after the subject documents were created, Congress considered the same amendment to Section 7525(b). *See* S. Rep. No. 108-011, at 93 (2003); H.R. Rep. No. 108-061, at 100 (2003). The *corporate tax* limitation itself provoked the proposed amendment in both of these bills "by making [the Section 7525(b) exception] applicable to all tax shelters, whether entered into by corporations, individuals, partnerships, tax-exempt entities, or any other entity." *Id*. Congress rejected that expansion in 2003.

The next year, Congress eliminated the limitation ***prospectively***. Section 813 of the American Jobs Creation Act of 2004 (JOBS) Act (Pub. L. No. 108-357), changed both the Section 7525(b) title and text. Compare the title applicable here ("SECTION NOT TO APPLY TO COMMUNICATIONS REGARDING ***CORPORATE TAX*** SHELTERS") to the prospectively amended title and text:

> (b) SECTION NOT TO APPLY TO COMMUNICATIONS REGARDING TAX SHELTERS. – The privilege under subsection (a) shall not apply to any written communication which is –
>
> > (1) between a federally authorized tax practitioner and –

(A) any person,

(B) any director, officer, employee, agent, or representative of the person, or

(C) any other person holding a capital or profits interest in the person, and

(2) in connection with the promotion of the direct or indirect participation of the person in any tax shelter (as defined in Section 6662(d)(2)(C)(ii)).

That affirmative elimination of the corporate tax limitation carries great weight. *Red Lion Broad. Co. v. FCC,* 395 U.S. 367, 380-81 (1969) ("Subsequent legislation declaring the intent of an earlier statute is entitled to great weight in statutory construction"). If any doubt existed about the import of that prospective change, the legislative history resolves it:

Present Law

. . . The Code provides that, with respect to tax advice, the same common law protections of confidentiality that apply to a communication between a taxpayer and a federally authorized tax practitioner to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney. ***This rule is inapplicable to communications regarding corporate tax shelters.***

Reasons for Change

The Committee believes that ***the rule currently applicable to corporate tax shelters*** should be applied to all tax shelters, regardless of whether or not the participant is a corporation.

Explanation of Provision

The provision ***modifies the rule relating to corporate tax shelters*** by making it applicable to all tax shelters, whether entered into by corporations, individuals, partnerships, tax-exempt entities, or any other entity. . .

H.R. Rep. No. 108-548, at 266 (2004). The Joint Committee on Taxation Report then echoes the House Report almost word for word. By statute, the *prospective* effect of eliminating the corporate tax shelter restriction applies to communications on or after October 22, 2004 – some three years after the communications at hand.

For these reasons, the Client/Intervenors ask the Court to grant their Petition and resolve these critical questions.

Respectfully submitted,

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OCTOBER 31, 2007

APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Nos. 05-3260 & 05-3518

[Filed July 2, 2007]

UNITED STATES OF AMERICA, Petitioner-Appellant, Cross-Appellee,	)
v.	)
BDO SEIDMAN, LLP, regarding IRS examination of BDO Seidman, LLP, Respondent-Appellee,	)
and,	)
ROBERT S. CUILLO, et al., Intervenors-Appellees, Cross-Appellants.	)

Before RIPPLE, KANNE and WILLIAMS, Circuit Judges.

OPINION

RIPPLE, *Circuit Judge*. This is the third appeal arising out of an effort by the Internal Revenue Service ("IRS") to enforce administrative summonses against

BDO Seidman, LLP ("BDO"), an accounting firm that allegedly failed to disclose potentially abusive tax shelters that it promoted. *See United States v. BDO Seidman,* 337 F.3d 802 (7th Cir. 2003) (*BDO II*); *United States v. BDO Seidman,* Nos. 02-3914 & 02-3915, 2002 U.S. App. LEXIS 28092, 2002 WL 32080709 (7th Cir. Dec. 18, 2002) (*BDO I*). The IRS now appeals the district court's ruling that sustained BDO's claim of attorney-client privilege with respect to a memorandum written by one of BDO's employees. The IRS also appeals a separate ruling that sustained the tax practitioner and/or attorney-client privilege asserted by a number of BDO's clients ("Intervenors") with respect to 266 documents. The Intervenors cross-appeal the district court's ruling that one document, Document A-40, fell within the crime-fraud exception to the attorney-client and/or tax practitioner privilege. For the reasons set for forth in this opinion, we affirm in part and vacate and remand in part.

I

BACKGROUND

A. The Enforcement Action

In September 2000, the IRS received information suggesting that BDO was promoting potentially abusive tax shelters without complying with the Internal Revenue Code's ("IRC") listing requirements for such tax shelters. *See* 26 U.S.C. §§ 6111(a), 6112(a) (2000); *BDO II,* 337 F.3d at 806. Potentially abusive tax shelters included those transactions defined as "tax shelters" under § 6111(c) and arrangements identified by regulation as potentially abusive under

§ 6112(b).[1] Organizers of any potentially abusive tax shelter were required to maintain a list of persons to whom an interest in the shelter was sold. *See* 26 U.S.C. § 6112(a) (2000). Additionally, organizers and sellers of § 6111(c) tax shelters were required to register the tax shelter with the IRS. *See id.* § 6111(a). Failure to follow these registration and list-keeping requirements was sanctionable by penalties. *See id.* §§ 6707, 6708.[2]

The IRS commenced a compliance investigation into BDO's alleged violations. The IRS issued twenty

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[1] Sections 6111 and 6112 of the IRC were amended by the American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 815, 118 Stat. 1418, 1581-83 (2004). The Act eliminated the distinction between § 6111(c) tax shelters and other arrangements identified by the Secretary under § 6112(b)(2) by replacing the terms "tax shelter" and "potentially abusive tax shelter" with "reportable transaction." Reportable transactions are "any transaction[s] with respect to which information is required to be included with a return or statement because . . . such transaction is of a type which the Secretary determines as having a potential for tax avoidance or evasion." 26 U.S.C. § 6707A. All reportable transactions must be reported to the IRS, *see id.* § 6111(a) (2000 & Supp. IV 2004), and must satisfy the IRC's list-keeping requirements, *see id.* § 6112(a).

[2] Sections 6707 and 6708 also were amended by the American Jobs Creation Act, *see* Pub. L. No. 108-357, §§ 816-817, 118 Stat. 1418, 1583-84 (2004), but they continue to provide penalties for failure to comply with the registration and list-keeping requirements of §§ 6111 and 6112. *See* 26 U.S.C. §§ 6707 & 6708 (2000 & Supp. IV 2004).

summonses commanding production of documents, testimony relating to the transactions and information on the identity of the clients who had invested in the transactions. *BDO II,* 337 F.3d at 805-06. When BDO resisted these summonses, the IRS petitioned the United States District Court for the Northern District of Illinois for enforcement. *Id.* at 806. BDO contended that the summonses could not be enforced because the investigation had no legitimate purpose. It also contended that the summonses were overbroad, issued in bad faith and sought information already in the IRS' possession. Lastly, BDO submitted that the information sought was irrelevant to the investigation. *Id.* at 806. BDO further asserted that a number of the documents were protected by the attorney-client privilege, the tax practitioner privilege under 26 U.S.C. § 7525(a) or work product protection. *BDO II,* 337 F.3d at 806. The district court ruled that the IRS had issued the summonses in good faith and that enforcement would not constitute an abuse of process. It ordered BDO to produce all responsive documents except for those previously listed on privilege logs and submitted to the court by BDO for in camera inspection. *Id.* at 806-07.

BDO then notified its clients that it intended to produce documents that would reveal their identities to the IRS. In response, a number of clients sought to intervene as of right in order to assert the tax practitioner privilege under 26 U.S.C. § 7525(a).[3] The district court denied the motions to intervene, holding

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[3] *See* John and Jane Does Emergency Motion to Intervene, R.38; Richard and Mary Roes Emergency Motion to Intervene, R.42.

that the tax practitioner privilege would not prevent disclosure of the clients' names. *See BDO II,* 337 F.3d at 807. The clients appealed this denial to this court.

On December 18, 2002, we entered an order remanding the case to the district court to permit it to undertake an in camera inspection of the documents for which the would-be anonymous intervenors asserted a privilege. *See BDO I,* 2002 U.S. App. LEXIS 28092. 2002 WL 32080709, at *1. We ordered the district court to make more extensive findings with respect to the claim of tax practitioner privilege for each document, taking into account the totality of the circumstances. *Id.* After conducting this in camera review, the district court determined that the tax practitioner privilege did not prevent disclosure of the clients' identities. R.73 at 7-31. The clients again appealed, and we affirmed the district court's ruling on the question of privilege and its denial of the motions to intervene. *BDO II,* 337 F.3d at 813.

After our decision affirming the district court's denial of the anonymous clients' motion to intervene, the Intervenors sought intervention as of right in order to assert a claim of privilege under the attorney-client privilege, tax practitioner privilege or work product doctrine with respect to 267 documents. The IRS filed a document titled "United States' Concurrence in Intervenors' Motions to Intervene and Challenge to Claims of Privilege" in which it argued that the district court should grant the motion, or, in the alternative, deny the claim of privilege. The IRS and the Intervenors also filed a joint motion in which the IRS consented to the intervention and the parties set forth

a proposed briefing schedule. On July 15, 2004, the district court granted the Intervenors' motion.

B. Intervenors' Claims

The Intervenors asserted attorney-client privilege, tax practitioner privilege or work product protection with respect to 267 documents. The IRS submitted that the documents either were not covered by the tax practitioner privilege under the tax shelter exception found in 26 U.S.C. § 7525(b), as it existed at the time of the communications, or that the documents fell within the crime-fraud exception to both the attorney-client and tax practitioner privileges.

According to the IRS, BDO, in conjunction with other firms, had engaged in the practice of selling prepackaged tax shelters, the sole purpose of which was the unlawful attempt to evade tax liability. The district court determined that the IRS had failed to make a prima facie showing of crime or fraud that would justify a blanket determination that all of the documents fell within the crime-fraud exception. R.178 at 16. The court noted that, just because the IRS characterized the transactions "as abusive and unlawful cookie cutter tax shelters," such a characterization did not make them so. *Id.* at 17. The court added that the question of whether BDO and the Intervenors had violated the IRC was the ultimate issue in the IRS' investigation and that a finding of fraud based solely on the IRS' allegations "would place the proverbial 'Cart before the Horse.'" *Id.* In a footnote, the district court added that, based on these same considerations, it could not hold that the Intervenors or BDO were engaged in tax shelters

which would fall within the tax shelter exception to the tax practitioner privilege. *Id.* at n.6.

Although the district court was unwilling to apply the crime-fraud exception in blanket fashion, it proceeded to review each document in camera to determine whether individual documents fell within the crime-fraud exception. *Id.* at 18. In conducting the review, the district court looked to the totality of the circumstances to determine whether there was sufficient evidence of crime or fraud to bring a document within this exception. *Id.* at 23. To guide this evaluation, the district court identified eight non-exclusive, non-determinative "potential indicators of fraud" which it drew from arguments made by the IRS, from two other cases involving allegedly fraudulent practices by BDO and from an unrelated IRS enforcement action against another accounting firm. R.178 at 23.[4] Based on these cases and other factors

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[4] The first case to which the district court looked in deriving its potential indicators of fraud was *Denney v. Jenkens & Gilchrist*, 340 F. Supp. 2d 338 (S.D.N.Y. 2004). That case involved a civil RICO class action in which the plaintiffs alleged that Jenkens & Gilchrist had developed and BDO and others had marketed a tax shelter known as the Currency Options Bring Reward Alternatives ("COBRA"). BDO sought to enforce an arbitration clause in its consulting agreements. Based on what it deemed to be admissions by the parties, the court in *Denney* concluded that BDO and its clients had engaged in mutual fraud in connection with the consulting agreements to conceal the true purpose of the agreements: providing the clients with tax shelters advice. *Id.* at 346. Because the contracts were the product of mutual fraud between BDO and its clients, the arbitration clause was

unenforceable. *Id.* at 347. The court based its conclusion that the contracts were mutually fraudulent on the vague language in the consulting agreements and its findings that BDO did not provide any of the consulting services described in the agreements. *Id.* at 346-47.

The next case the district court looked to in developing its potential indicators of fraud was *Miron v. BDO Seidman, LLP*, 342 F. Supp. 2d 324 (E.D. Pa. 2004). Like *Denney, Miron* involved the enforceability of an arbitration clause in one of BDO's consulting agreements and related to the COBRA transaction. *See id.* at 327. The district court in *Miron* noted the factors that led the court in *Denney* to find that the consulting agreements had been the product of mutual fraud, but concluded that the consulting agreements at issue were factually distinguishable. *See id.* at 329-30. In particular, the court found that BDO had provided the services described in its consulting agreements. *Id.* The court in *Miron* noted also that, unlike the consulting agreements in *Denney*, in which the only identified goal was expanding business operations, the consulting agreements at issue were intended to limit also the clients' financial exposure on those expansions. *Id.* at 329. Based on these differences, the court concluded that the consulting agreements were not similarly suggestive of fraud. *Id.*

The third case to which the district court looked in arriving at its potential indicators of fraud was *United States v. KPMG LLP*, 316 F. Supp. 2d 30 (D.D.C. 2004). Unlike *Denney* and *Miron*, *KPMG* did not involve BDO. *KPMG* involved an action brought by the IRS to enforce summonses it issued to the accounting firm of KPMG as part of its investigation into KPMG's alleged promotion of, and participation in, tax shelters. *Id.* at 31-32. The court in *KPMG* held that boilerplate opinion letters provided to KPMG

that the IRS had submitted were indicative of fraud, the district court arrived at the following eight factors to guide its in camera review of each of the 267 documents:

> (1) the marketing of pre-packaged transactions by BDO; (2) the communication by the Intervenors to BDO with the purpose of engaging in a pre-arranged transaction developed by BDO or [a] third party with the sole purpose of reducing taxable income; (3) BDO and/or the Intervenors attempting to conceal the true nature of the transaction; (4) knowledge by BDO, or a situation where BDO should have known, that the Intervenors lacked a legitimate business purpose for entering into the transaction; (5) vaguely worded consulting agreements; (6) failure by BDO to provide services under the consulting agreement yet receipt of payment; (7) mention of the COBRA transaction; and (8) use of boiler-plate documents.

R.178 at 23. The court further noted that the presence of these factors alone would not be sufficient to establish a prima facie case of fraud. *See id.* at 23-24.

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clients by the law firm of Brown & Wood were not protected by the attorney-client privilege because they had been provided as a part of "KPMG's marketing machine" rather than as reasoned legal advice. *Id.* at 40. The district court in the present action found the findings of the court in *KPMG* consistent with the IRS' allegation that BDO had engaged in the promotion of prepackaged tax shelters rather than individualized tax advice. *See* R.178 at 23.

Rather, the potential indicators of fraud were intended to serve merely as guideposts. *See id.* at 24. The ultimate question of whether a prima facie showing of crime or fraud had been made with respect to a particular document was to be determined under the totality of circumstances.

Based on this review, the district court held that, with the exception of Document A-40, the IRS had failed to make a prima facie showing of a crime or fraud. *Id.* at 24. Thus, the district court upheld the Intervenors' claim of privilege with respect to 266 of the 267 documents, although it did not specify which privilege (attorney-client or tax practitioner) applied to each document. *See id.* at 13-14, 29.

After finding prima facie evidence that Document A-40 fell within the crime-fraud exception, the district court permitted the Intervenors to provide an explanation that would negate the evidence of crime or fraud. *Id.* at 24. The Intervenors provided their explanation to the court and the IRS responded. On May 17, 2005, after finding the Intervenors' explanation insufficient to rebut the prima facie evidence of crime or fraud, the district court ruled that Document A-40 fell within the crime-fraud exception to the tax practitioner or attorney-client privilege. R.190 at 10.

After the district court issued its final ruling with respect to Document A-40, the Court of Appeals for the Second Circuit reversed the decision of the United States District Court for the Southern District of New York in *Denney v. Jenkens & Gilchrist*, 340 F. Supp. 2d 338 (S.D.N.Y. 2004). *See Denney v. BDO Seidman,*

L.L.P., 412 F.3d 58, 66 (2d Cir. 2005). The Intervenors moved for reconsideration under Rule 60(b) of the Federal Rules of Civil Procedure, arguing that, because the district court had relied on *Denney* when establishing the factors that would guide its in camera review of each document, the court should reexamine its earlier ruling. R.210 at 2-3. The district court denied the motion, holding that the Second Circuit's decision did not affect the controlling law in this case. *Id.* at 3. The court added that its finding of prima facie evidence of crime or fraud was based on the totality of the circumstances, an inquiry guided, but not controlled, by the eight factors it previously had identified. *Id.* at 6.

C. BDO's Privilege Claims

While its clients were seeking to intervene to protect their claims of privilege, BDO asserted its own claims of attorney-client privilege and work product protection with respect to 110 documents. The IRS responded that the documents were neither protected attorney-client communications nor work product, and, even if they were, the documents fell within the crime-fraud exception. R.127 at 2. After conducting an in camera inspection of each document, the district court determined that 103 of the documents were within the attorney-client privilege and that one other document, though not covered by the attorney-client privilege, fell within the work product doctrine. *Id.* at 3-9. However, the court concluded that six documents, as submitted to the court in redacted form, were not within the attorney-client privilege and ordered their disclosure as so redacted. *Id.* at 7. Based on the same in camera review, the district court found no evidence that the

communications in 104 documents protected by the attorney-client privilege or work product doctrine were made to further a crime or fraud. *Id.* at 10.

One of the 104 documents that the district court had found to fall within the attorney-client privilege was a memorandum written by Michael Kerekes ("Kerekes Memorandum"). Kerekes was a lawyer and partner at BDO. In August 2000, he wrote a memorandum to BDO's outside counsel, David Dreier, a tax attorney with the law firm of White & Case LLP, requesting legal advice on pending IRS regulations. In January 2001, Donna Guerin, an attorney at the law firm of Jenkens & Gilchrist, received a copy of the memorandum under circumstances that remain the subject of dispute.[5] At the time attorney Guerin

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[5] Guerin received the memorandum by fax. She asserts that the memorandum was sent to her by Robert Greisman, a partner with BDO. Greisman contends that he does not remember faxing the memorandum to Guerin and that on the day it was faxed to her he was at a meeting at a hotel in Los Angeles. There is no record of a fax having been sent from the hotel to Jenkens & Gilchrist on that day and the document itself does not display the phone number of the origin of the fax. Further, the memorandum was not received in a single transmission. The last three pages of the memorandum were sent at around 3:20 p.m., with the balance of the memorandum, that is, the first portion of the memorandum, being sent in a separate transmission at around 4:00 p.m. In addition to the memorandum being sent out of order in two transmissions, the fax heading indicates that those portions of the memorandum sent at around 3:20 p.m. began at the second page of the transmission. The fax heading of the transmission sent around 4:00 p.m. indicates that the portion of the, memorandum

received the Kerekes Memorandum, Jenkens & Gilchrist did not represent BDO, but these two entities, one an accounting firm and the other a law firm, serviced jointly clients on the same or related matters. According to attorney Guerin, she received the letter from BDO as input into an opinion letter regarding tax shelters that Jenkens & Gilchrist was preparing for both BDO and their common clients. Although BDO and Jenkens & Gilchrist subsequently were co-defendants in civil litigation, *see, e.g., Denney v. Jenkens & Gilchrist,* 340 F. Supp. 2d 338, there was no litigation pending against BDO or Jenkens & Gilchrist at the time attorney Guerin received the Kerekes Memorandum.

After the district court's ruling on BDO's claim of privilege for the 110 documents, the IRS received the Kerekes Memorandum from Jenkens & Gilchrist in response to a subpoena. Upon viewing the memorandum, the IRS requested the court reconsider its privilege ruling with respect to the Kerekes Memorandum. The IRS asserted that the document fell within the crime-fraud exception to the attorney-client privilege or, alternatively, that the privilege had been waived. Based on its prior in camera review of the document, the district court rejected the IRS' claim that the Kerekes Memorandum fell within the crime-fraud exception. R.180 at 3-4. The court noted that, even though the contents of the Kerekes Memorandum were new to the IRS, they were not new to the court, and it had considered the arguments presented by the

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sent at that time began at the eighth page of the transmission. The balance of both transmissions does not appear in the record.

IRS in its prior in camera review of the Kerekes Memorandum. The district court further held that disclosure of the Kerekes Memorandum to attorney Guerin did not waive BDO's claim of privilege because the memorandum related to a common legal interest shared by BDO and Jenkens & Gilchrist and therefore fell within the common interest doctrine. *Id.* at 6. The district court added that it would reach the same conclusion even if the common interest doctrine did not apply because it had found ample precedent to sustain the privilege as an unintentional disclosure. *Id.*

II

DISCUSSION

The IRS timely appealed the district court's ruling with respect to the Kerekes Memorandum. The IRS contends that BDO waived any claim of privilege with respect to the memorandum when it disclosed the document to attorney Guerin. The IRS submits that the common interest doctrine does not apply because the communication was not made in anticipation of litigation. It further contends that the disclosure was voluntary, and, therefore, BDO cannot claim that the privilege is preserved because any disclosure was inadvertent. Alternatively, the IRS contends that the district court erred by not reconsidering its ruling that there was no evidence of crime or fraud in connection with the Kerekes Memorandum after it found such evidence with respect to Document A-40.

The IRS also appeals the district court's ruling that the tax shelter exception to the tax practitioner privilege, 26 U.S.C. § 7525(b) (2000), does not apply to

the 267 documents for which the Intervenors claimed the privilege. The IRS contends that the burden was on the Intervenors to prove that the tax shelter exception did not apply, a burden the IRS claims the Intervenors did not meet.

The Intervenors cross-appeal the district court's finding of prima facie evidence of crime or fraud with respect to Document A-40. The Intervenors submit that the district court's finding was in error because the IRS failed to make a prima facie showing of each element of a particular crime or common law fraud.

A. The Kerekes Memorandum

We first shall address whether the district court erred in sustaining BDO's claim of attorney-client privilege under the common interest doctrine and in rejecting the IRS' position that the Kerekes Memorandum fell within the crime-fraud exception to the attorney-client privilege.

We review all necessary findings of fact and all applications of law to fact in connection with the district court's ruling on a privilege claim for clear error. *See United States v. Frederick,* 182 F.3d 496, 499 (7th Cir. 1999) (application of law to fact); *United States v. Evans,* 113 F.3d 1457, 1461 (7th Cir. 1997) (findings of fact). We shall reverse only if, on review of the entire evidence, we are "left with the definite and firm conviction that a mistake has been committed." *Malachinski v. Comm'r,* 268 F.3d 497, 505 (7th Cir. 2001) (quoting *Coleman v. Commissioner,* 16 F.3d 821, 824 (7th Cir. 1994)) (internal quotation marks omitted). On the other hand, the scope of a privilege is

a question of law that we review de novo. *See BDO II*, 337 F.3d at 809. We review a district court's decision regarding the crime-fraud exception for an abuse of discretion. *United States v. Al-Shahin*, 474 F.3d 941, 946 (7th Cir. 2007).

In federal courts, except when state law supplies the applicable rule of law, the attorney-client privilege is "governed by the principles of the common law as [it] may be interpreted by the courts of the United States in the light of reason and experience." Fed. R. Evid. 501. Although it ultimately was not adopted by Congress, the rule of attorney-client privilege promulgated by the Supreme Court in 1972 as part of the Proposed Federal Rules of Evidence has been recognized "as a source of general guidance regarding federal common law principles." *In re Grand Jury Investigation*, 399 F.3d 527, 532 (2d Cir. 2005); *see also* 3 Jack B. Weinstein & Margaret A. Berger, Weinstein's Federal Evidence § 503.02 (Joseph M. McLaughlin, ed., 2d ed. 2006). Proposed Rule 503 provided:

> A client has a privilege to refuse to disclose and to prevent any other person from disclosing confidential communications made for the purpose of facilitating the rendition of professional legal services to the client, (1) between himself or his representative and his lawyer or his lawyer's representative, or (2) between his lawyer and the lawyer's representative, or (3) by him or his lawyer to a lawyer representing another in a matter of common interest, or (4) between representatives of the client or between the client and a

> representative of the client, or (5) between lawyers representing the client.

See Proposed Fed. R. Evid. 503(b), 56 F.R.D. 183, 236 (1972). Put simply, in order for the attorney-client privilege to attach, the communication in question must be made: (1) in confidence; (2) in connection with the provision of legal services; (3) to an attorney; and (4) in the context of an attorney-client relationship.

The purpose of the privilege is to "encourage full disclosure and to facilitate open communication between attorneys and their clients." *BDO II*, 337 F.3d at 810. Open communication assists lawyers in rendering legal advice, not only to represent their clients in ongoing litigation, but also to prevent litigation by advising clients to conform their conduct to the law and by addressing legal concerns that may inhibit clients from engaging in otherwise lawful and socially beneficial activities. *See Frederick*, 182 F.3d at 500. The cost of these benefits is the withholding of relevant information from the courts. *BDO II*, 337 F.3d at 811.

Recognizing the inherent tension between the beneficial goals of the attorney-client privilege and the courts' right to every person's evidence, the courts have articulated the following principles to inform our analysis of the scope of the common interest doctrine:

> (1) "[C]ourts construe the privilege to apply only where necessary to achieve its purpose." *Id.*
>
> (2) Only those communications which "reflect the lawyer's thinking [or] are made for

the purpose of eliciting the lawyer's professional advice or other legal assistance" fall within the privilege. *Frederick,* 182 F.3d at 500.

(3) Because one of the objectives of the privilege is assisting clients in conforming their conduct to the law, litigation need not be pending for the communication to be made in connection to the provision of legal services. *See United States v. Schwimmer,* 892 F.2d 237, 243-44 (2d Cir. 1989).

(4) Because "the privilege is in derogation of the search for truth," any exceptions to the requirements of the attorney-client privilege "must be strictly confined." *In re Grand Jury Proceedings (Thullen),* 220 F.3d 568, 571 (7th Cir. 2000).

Although occasionally termed a privilege itself, the common interest doctrine is really an exception to the rule that no privilege attaches to communications between a client and an attorney in the presence of a third person. *See Robinson v. Texas Auto. Dealers Ass'n,* 214 F.R.D. 432, 443 (E.D. Tex. 2003). In effect, the common interest doctrine extends the attorney-client privilege to otherwise non-confidential communications in limited circumstances. For that reason, the common interest doctrine only will apply where the parties undertake a joint effort with respect to a common legal interest, and the doctrine is limited strictly to those communications made to further an ongoing enterprise. *See Evans,* 113 F.3d at 1467. Other than these limits, however, the common defense doctrine does not contract the attorney-client privilege.

Thus, communications need not be made in anticipation of litigation to fall within the common interest doctrine.[6] Applying the common interest doctrine to the full range of communications otherwise protected by the attorney-client privilege encourages parties with a shared legal interest to seek legal "assistance in order to meet legal requirements and to plan their conduct" accordingly. *See In re Regents of the Univ. of California,* 101 F.3d 1386, 1390-91 (Fed. Cir. 1996). This planning serves the public interest by advancing compliance with the law, "facilitating the administration of justice" and averting litigation. *Id.* at 1391. Reason and experience demonstrate that joint

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[6] The weight of authority favors our conclusion that litigation need not be actual or imminent for communications to be within the common interest doctrine. At least five of our sister circuits have recognized that the threat of litigation is not a prerequisite to the common interest doctrine. *See In re Grand Jury Subpoena (Custodian of Records, Newparent, Inc.),* 274 F.3d 563, 572 (1st Cir. 2001); *In re Regents of the Univ. of California,* 101 F.3d 1386, 1390-91 (Fed. Cir. 1996); *United States v. Aramony,* 88 F.3d 1369, 1392 (4th Cir. 1996); *United States v. Schwimmer,* 892 F.2d 237, 244 (2d Cir. 1989); *United States v. Zolin,* 809 F.2d 1411, 1417 (9th Cir. 1987), *aff'd in part and vacated in part on other grounds, United States v. Zolin,* 491 U.S. 554, 109 S. Ct. 2619, 105 L. Ed. 2d 469 (1989). We have found only one circuit that requires a "palpable threat of litigation at the time of the communication." *United States v. Newell,* 315 F.3d 510, 525 (5th Cir. 2002) (quoting *In re Santa Fe Int'l Corp.,* 272 F.3d 705, 711 (5th Cir. 2001)). This position runs contrary to the "established [rule] that the attorney-client privilege is not limited to actions taken and advice obtained in the shadow of litigation." *In re Regents of the Univ. of California,* 101 F.3d at 1390.

venturers, no less than individuals, benefit from planning their activities based on sound legal advice predicated upon open communication.

Having determined that BDO is not barred from asserting attorney-client privilege under the common interest doctrine simply because it was not shared under the threat of litigation, we next shall determine whether the district court's ruling on BDO's claim of privilege was clearly erroneous. The district court recognized that the scope of the common interest doctrine is limited to a common *legal* interest to which the parties formed a common strategy. *See* R.180 at 6. The district court concluded that BDO and Jenkens & Gilchrist, acting as joint venturers, shared a common legal interest "in ensuring compliance with the new regulation issued by the IRS," *id.*, and in making sure that they could defend their product against potential IRS enforcement actions.

There was, moreover, sufficient evidence to support the district court's determination in this regard. The Kerekes Memorandum originally was addressed to BDO's outside counsel, White & Case, and it sought advice on a legal question. At the time attorney Guerin received the Kerekes Memorandum, BDO and Jenkens & Gilchrist jointly serviced a number of common clients with respect to certain tax products. According to Guerin, Robert Greisman, a partner at BDO, sent her the memorandum as part of BDO's effort to coordinate with Jenkens & Gilchrist a common legal

position that BDO and Jenkens & Gilchrist would communicate later to these common clients.[7]

Nonetheless, the IRS asserts that, because the purpose of the communication was to coordinate the content of the message to their common clients, the communication between BDO and Jenkens & Gilchrist was not made for the purpose of securing advice with respect to a common legal interest and, therefore, was not within the scope of the common interest doctrine. However, even if the ultimate reason for sharing the Kerckes Memorandum was to advance the joint interests of BDO and Jenkens & Gilchrist in their representations to their common clients, it does not follow that the communication itself was not made to secure legal advice with respect to a common legal interest. Communications do not cease to be for the purpose of receiving legal services just because the recipient intended to use the fruits of the legal services to guide its relations with customers. In essence, through the memorandum, two joint venturers, BDO and Jenkens & Gilchrist, undertook a consultation between their respective in-house counsel and BDO's outside counsel with respect to the legality of the proposed financial course of action they would recommend to their common clients. This effort, as the district court recognized, was clearly within the scope of the common interest doctrine.

The district court's findings do not leave us "with the definite and firm conviction that a mistake has

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[7] There is no contention that the final communication from the joint venturers to their clients was privileged.

been committed." *Malachinski,* 268 F.3d at 505 (quoting *Coleman,* 16 F.3d at 824) (internal quotation marks omitted). The district court's finding that the communication of the Kerekes Memorandum to attorney Guerin was within the common interest doctrine was not clearly erroneous. Further, because the privileged status of communications falling within the common interest doctrine cannot be waived without the consent of all of the parties, Jenkens & Gilchrist's subsequent voluntary disclosure of the Kerekes Memorandum in response to the IRS' subpoena did not waive BDO's claim of privilege. *See John Morrell & Co. v. Local Union 304A of the United Food & Commercial Workers,* 913 F.2d 544, 556 (8th Cir. 1990); *In re Grand Jury Subpoenas (89-3 & 89-4, John Doe 89-129),*902 F.2d 244, 248 (4th Cir. 1990); *see also* Advisory Committee's Note, Proposed Fed. R. Evid. 503(b), 56 F.R.D. 183, 239 (1972).[89]

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[8] The district court held in the alternative that, even if the Kerekes Memorandum did not fall within the common interest doctrine, disclosure of the memorandum by BDO to attorney Guerin was inadvertent. The court concluded that, because the disclosure was inadvertent, BDO had not waived its claim of privilege for the memorandum. The IRS also challenges this alternative holding. Because the district court's application of the common interest doctrine was not clear error, we need not address this alternative ruling.

[9] The IRS contends that, after the court found that Document A-40 fell within the crime-fraud exception, the district court should have revisited its conclusion that the crime-fraud exception to the attorney-client privilege did not vitiate the privilege with respect to the Kerekes Memorandum.

The IRS *did* challenge specifically the district court's earlier determination that the crime-fraud exception did not apply to the Kerekes Memorandum. *See* R.152 (sealed). This challenge predated, however, the district court's determination with respect to Document A-40. Indeed, on the same day that the district court announced its initial conclusion that the IRS had made a prima facie showing that the communications in Document A-40 were made in furtherance of crime or fraud, the district court rejected the IRS' identical challenge to the Kerekes Memorandum. At no time after the district court stated that it had found prima facie evidence of crime or fraud with respect to Document A-40 did the IRS request the district court to re-evaluate its earlier ruling with respect to the Kerekes Memorandum. The IRS was not without opportunity to raise the issue. As discussed in greater detail in Part II.B, after concluding that there was prima facie evidence that Document A-40 fell within the crime-fraud exception, both the Intervenors and the IRS were permitted to submit additional arguments about the applicability of the crime-fraud exception to Document A-40. The IRS availed itself of this opportunity and filed additional memoranda with the court opposing the Intervenors' answer to the court's preliminary findings of crime or fraud with respect to Document A-40. Nowhere in these papers did the IRS request the district court revisit its earlier rulings on the Kerekes Memorandum.

Based on this record, we must conclude that the IRS has waived this issue. We have recognized that the waiver rule exists to provide the district court with the first opportunity to rule on a party's theories. *Bailey v. Int'l Bhd. of Boilermakers, Iron Ship Builders, Blacksmiths, Forgers & Helpers, Local 374*, 175 F.3d 526, 530 (7th Cir. 1999). This requirement assures that we shall not usurp the role of the district court by engaging in initial fact finding. *Id.* It also assures an adequate record for review, *id.*, a

B. Document A-40

We now address whether the district court erred when it held that the Intervenors could not assert a privilege with respect to Document A-40 because the document fell within the crime-fraud exception to the attorney-client and tax practitioner privileges. We review a district court's decision regarding the crime-fraud exception for an abuse of discretion. *Al-Shahin*, 474 F.3d at 946.

The crime-fraud exception places communications made in furtherance of a crime or fraud outside the attorney-client privilege. *United States v. Zolin*, 491 U.S. 554, 563, 109 S. Ct. 2619, 105 L. Ed. 2d 469 (1989). The exception is based on the recognition that the privilege necessarily will "protect the confidences of wrongdoers." *Id.* at 562. This cost is accepted as necessary to achieve the privilege's purpose of promoting the "broader public interests in the observance of law and the administration of justice." *Id.* (quoting *Upjohn Co. v. United States*, 449 U.S. 383, 389, 101 S. Ct. 677, 66 L. Ed. 2d 584 (1981)) (internal quotation marks omitted). However, when the advice sought relates "*not to prior wrongdoing*, but to *future wrongdoing*," the privilege goes beyond what is necessary to achieve its beneficial purposes. *Id.* at 562-

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particularly important function in cases such as this one, where the fact-specific nature of the inquiry lies within the trial court's particular expertise, *see Frederick*, 182 F.3d at 499. Because the issue the IRS presents on appeal was never before the district court, we are left with no basis to evaluate the district court's ruling on a particularly fact-bound issue. The issue is waived.

63 (quoting 8 John Henry Wigmore, Evidence In Trials At Common Law § 2298 (John T. McNaughton rev. 1961)) (internal quotation marks omitted) (emphasis in original).

To invoke the crime-fraud exception, the party seeking to abrogate the attorney-client privilege must present prima facie evidence that "gives colour to the charge" by showing "some foundation in fact." *Al-Shahin*, 474 F.3d at 946 (quoting *Clark v. United States*, 289 U.S. 1, 15, 53 S. Ct. 465, 77 L. Ed. 993 (1933)) (internal quotation marks omitted). The party seeking to abrogate the privilege meets its burden by bringing forth sufficient evidence to justify the district court in requiring the proponent of the privilege to come forward with an explanation for the evidence offered against it. *See United States v. Davis*, 1 F.3d 606, 609 (7th Cir. 1993). The privilege will remain "if the district court finds [the] explanation satisfactory." *Id.*

BDO and the Intervenors would require the party seeking to abrogate the attorney-client privilege to make out a prima facie case of each element of a particular crime or common law fraud to invoke the crime-fraud exception. Such a burden is inconsistent with our requirement that the party seeking to abrogate the privilege need only "give colour to the charge" by showing "some foundation in fact." *Al-Shahin*, 474 F.3d at 946 (quoting *Clark*, 289 U.S. at 15) (internal quotation marks omitted). The approach advocated by BDO and the Intervenors reflects the view of some circuits, which require enough evidence of crime or fraud to support a verdict in order to invoke the crime-fraud exception. *See In re Feldberg*, 862 F.2d

622, 625 (7th Cir. 1988). We expressly have rejected that approach. *See id.*

We therefore must determine whether the district court abused its discretion in determining that the IRS had come forward with sufficient evidence to give color to its charge that Document A-40 was a communication in furtherance of a crime or fraud. The district court engaged in a document-by-document, in camera inspection of all 267 documents for which the Intervenors claimed a privilege to determine whether they fell within the crime-fraud exception. R.178 at 18. In determining whether there was prima facie evidence of criminal or fraudulent activity, the court looked at the totality of the circumstances, including the eight "potential indicators of fraud" discussed above.[10] *See id.* at 23. Based on the totality of

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[10] As noted above, the eight potential indicators of fraud identified by the district court were:

> (1) the marketing of pre-packaged transactions by BDO; (2) the communication by the Intervenors to BDO with the purpose of engaging in a pre-arranged transaction developed by BDO or [a] third party with the sole purpose of reducing taxable income; (3) BDO and/or the Intervenors attempting to conceal the true nature of the transaction; (4) knowledge by BDO, or a situation where BDO should have known, that the Intervenors lacked a legitimate business purpose for entering into the transaction; (5) vaguely worded consulting agreements (6) failure by BDO to provide services under the consulting agreement yet receipt of payment; (7) mention of the

circumstances, the district court found no prima facie evidence of crime or fraud with respect to 266 of the documents, a ruling that the IRS does not challenge.

Applying the same totality of the circumstance approach, the district court found prima facie evidence of crime or fraud with respect to Document A-40 and instructed the Intervenors to come forward with an explanation that would rebut the evidence. *Id.* at 24. The Intervenors responded and the IRS provided further evidence to rebut the Intervenors' response. After considering all of the evidence, the district court concluded that the Intervenors had failed to rebut the prima facie showing of crime or fraud. R.190 at 10.

The Intervenors now challenge the district court's ruling. First, the Intervenors point to the decision of the United States Court of Appeals for the Second Circuit in *Denney v. BDO Seidman, L.L.P.*, 412 F.3d 58 (2005), which reversed *Denney v. Jenkens & Gilchrist*, one of the cases from which the district court derived its potential indicators of fraud.[11] *See Denney v. BDO Seidman*, 412 F.3d at 66. The Second Circuit's decision in *Denney v. BDO Seidman* does not draw into

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COBRA transaction; and (8) use of boiler-plate documents.

R.178 at 23.

[11] The potential indicators of fraud the district court drew from *Denney v. Jenkens & Gilchrist* were mention of the COBRA transaction, vaguely worded consulting agreements and failure to provide services under the consulting agreements.

question the district court's totality of the circumstances analysis in this case.

In *Denney v. BDO Seidman,* the Second Circuit held that the District Court for the Southern District of New York had erred when it concluded, without factual support in the record, that the parties had agreed that their agreements were mutually fraudulent. *Denney v. BDO Seidman,* 412 F.3d at 66. The Second Circuit's decision did not address whether facts such as mention of the COBRA transaction, vaguely worded consulting agreements or failure to provide services under the consulting agreements, i.e., the factors that the district court in the present case derived from *Denney v. Jenkens & Gilchrist,* would be indicative of fraud. Moreover, the district court in the present case did not place dispositive weight on any one of the "potential indicators of fraud," nor did the court limit its analysis to the eight potential indicators. R.190 at 5.

The remainder of the Intervenors' challenge asserts that the IRS could not defeat the Intervenors' claim of privilege under the crime-fraud exception because the IRS had failed to allege a particular offense or the elements of common law fraud, and, in any event, the Intervenors had come forward with rebuttal evidence showing a legitimate purpose underlying the transactions in question. As we already have noted, our case law does not require a party seeking to invoke the crime-fraud exception to allege a particular offense or to make a prima facie showing with respect to each element of common law fraud. The IRS only was required to present sufficient evidence to "give colour to the charge" that the communication was made in

furtherance of a crime or fraud by showing "some foundation in fact." *Al-Shahin*, 474 F.3d at 946 (quoting *Clark*, 289 U.S. at 15) (internal quotation marks omitted).

After concluding that there had been a prima facie showing that Document A-40 was a communication made in furtherance of a crime or fraud, the district court gave the Intervenors the opportunity to explain the communication. The Intervenors offered an explanation, but the district court did not find it satisfactory. Nor was the district court required to find the explanation satisfactory. Thus, the district court did not abuse its discretion when it concluded that the IRS had made a prima facie showing of crime or fraud which the Intervenors failed to explain satisfactorily.

C. Tax Practitioner Privilege

We now shall address whether the district court correctly applied the tax practitioner privilege found in § 7525 to the facts of this case. Prior to 2004, § 7525 provided:

> § 7525. Confidentiality privileges relating to taxpayer communications
>
> (a) Uniform application to taxpayer communications with federally authorized practitioners.--
>
> (1) General rule.--With respect to tax advice, the same common law protections of confidentiality which apply to a communication between a tax-payer and an attorney shall also

apply to a communication between a taxpayer and any federally authorized tax practitioner to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney.

(2) Limitations. Paragraph (1) may only be asserted in--

(A) any noncriminal tax matter before the Internal Revenue Service; and

(B) any noncriminal tax proceeding in Federal court brought by or against the United States.

(3) Definitions. For purposes of this subsection--

(A) Federally authorized tax practitioner. The term "federally authorized tax practitioner" means any individual who is authorized under Federal law to practice before the Internal Revenue Service if such practice is subject to Federal regulation under section 330 of title 31, United States Code.

(B) Tax advice. The term "tax advice" means advice given by an individual with respect to a matter which is within the scope of the individual's authority to practice described in sub-paragraph (A).

(b) Section not to apply to communications regarding corporate tax shelters. The privilege

> under subsection (a) shall not apply to any written communication between a federally authorized tax practitioner and a director, shareholder, officer, or employee, agent, or representative of a corporation in connection with the promotion of the direct or indirect participation of such corporation in any tax shelter (as defined in section 6662(d)(2)(C)(iii)).

26 U.S.C. § 7525 (2000). To determine whether the district court correctly applied § 7525, we first must address: (1) the elements of the privilege and, specifically, whether the "exception" to the privilege for communications related to tax shelters is an element of the privilege or whether it is a true exception; and (2) the scope of the tax shelter exception.

1. Elements of the Tax Practitioner Privilege

As with all assertions of privilege, the proponent of the tax practitioner privilege must establish each element of the privilege. *See BDO II*, 337 F.3d at 811. On the other hand, with respect to exceptions to the privilege, the burden rests on the party seeking to overcome an otherwise valid claim of privilege to prove preliminary facts that would support a finding that the claimed privilege falls within an exception. *See* Charles Alan Wright & Kenneth W. Graham, Jr., 24 Federal Practice & Procedure § 5507, at 571 (1986).

The IRS submits that § 7525(b)'s ("subsection (b)") tax shelter "exception" to the tax practitioner privilege is not an exception to the privilege, but an element of the privilege itself. Thus, under the IRS' theory, the party asserting the privilege must establish that the

communication was not made, in the words of the statute, "in connection with the promotion of the direct or indirect participation . . . in any tax shelter." 26 U.S.C. § 7525(b) (2000). The Intervenors, on the other hand, contend that the tax shelter "exception" is a true exception to the tax practitioner privilege, and, consequently, the opponent of the privilege bears the burden of establishing that the communication falls within the exception.

Prior to the American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418 (2004),[12] subsection (b) read:

> The privilege under subsection (a) shall not apply to any written communication between a federally authorized tax practitioner and a

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[12] The American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418 (2004), amended subsection (b) to read:

> The privilege under subsection (a) shall not apply to any written communication which is--
>
> (1) between a federally authorized tax practitioner and
>
> (A) any person,
>
> (B) any director, officer, employee, agent, or representative of the person, or
>
> (C) any other person holding a capital or profits interest in the person, and
>
> (2) in connection with the promotion of the direct or indirect participation of the person in any tax shelter (as defined in section 6662(d)(2)(C)(ii)).

26 U.S.C. § 7525(b) (2000 & Supp. IV 2004). These changes applied only to communications made after October 24, 2004. *See* American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 813(b), 118 Stat. 1418, 1581 (2004). The Act did not amend the elements of the tax practitioner privilege set forth in § 7525(a).

> director, shareholder, officer, or employee, agent, or representative of a corporation in connection with the promotion of the direct or indirect participation of such corporation in any tax shelter (as defined in section 6662(d)(2)(C)(iii)).

26 U.S.C. § 7525(b) (2000). The plain wording of this subsection evinces a clear intent to treat the rule embodied in subsection (b) as an exception to the tax practitioner privilege. The first sentence of subsection (b) refers to "the privilege under subsection (a)." *Id.* The fact that the privilege does not apply to the class of communications described in subsection (b) presupposes the existence of an otherwise applicable privilege.

This conclusion is supported further by the structure of § 7525 as a whole. Section 7525(a) ("subsection (a)") sets out a general rule, *id.* § 7525(a)(1), specific limitations on the situations in which that rule may be asserted, *id.* § 7525(a)(2), and defines key terms that further limit the scope of the rule, *id.* § 7525(a)(3). By placing some specific limitations on the general rule together with the general rule in subsection (a) while placing other limitations on the general rule in subsection (b), the structure of the statute suggests that not all limitations to the privilege are of the same character. The most natural reading of the section as a whole is to consider those limitations to the scope of the general rule found in subsection (a) to constitute elements of the privilege and those limitations found in subsection (b) as exceptions to the application of that privilege.

The rationale underlying the tax shelter exception further supports this conclusion. Subsection (b) originally was added in conference committee. The report of the conference committee explained that "[t]he Conferees [did] not understand the promotion of tax shelters to be part of the routine relationship between a tax practitioner and a client." H.R. Rep. No. 105-599 at 269 (1998) (Conf. Rep.). This rationale is analogous to the rationale underlying the crime-fraud exception, i.e., advice given to further future crime or fraud goes beyond what is necessary to achieve the beneficial aims of the privilege. *See Zolin*, 491 U.S. at 562. Thus, in both situations, the rationale underlying the limitation on the claimed privilege goes to the necessity of the communications to achieve the beneficial aims of the privilege.

Thus, based on the text, structure and purpose of subsection (b), it is clear that the tax shelter "exception" is a true exception to the tax practitioner privilege. As with any other exception to a claimed privilege, the burden rests on the opponent of the privilege to prove preliminary facts that would support a finding that the claimed privilege falls within an exception. *Cf.* Wright & Graham, 24 Federal Practice & Procedure § 5507, at 571. As with the crime-fraud exception, the opponent meets this burden by bringing forth enough evidence to show "some foundation in fact" that the exception applies. *Cf. Al-Shahin*, 474 F.3d at 946 (quoting *Clark*, 289 U.S. at 15) (internal quotation marks omitted).

2. Scope of the Tax Shelter Exception

The Intervenors contend that the tax shelter exception found in subsection (b) applies only to tax shelters that shelter corporate taxes. The Intervenors rely on the subsection's heading and the legislative history of subsection (b) to support this contention. The IRS, on the other hand, submits that the tax shelter exception, as it existed in 2002, was not so limited. To support its position, the IRS relies on the text of the statute and the legislative history of subsection (b). The question thus becomes whether the tax shelter to which the communication relates must shelter corporate, as opposed to individual, taxes.

We begin with the text of the statute. "Only if the plain language of the statute is inconclusive or clearly contravenes expressed congressional intent do we look beyond the words themselves." *Oneida Tribe of Indians v. Wisconsin,* 951 F.2d 757, 761 (7th Cir. 1991). To discern the scope of the tax shelter exception, we must look to the elements of the exception. To fall within subsection (b), a communication must be: (1) written; (2) "between a federally authorized tax practitioner and a director, shareholder, officer, or employee, agent, or representative of a corporation"; and (3) made "in connection with the promotion of the direct or indirect participation of such corporation in any tax shelter" as defined by 26 U.S.C. § 6662(d)(2)(C)(ii).[13] 26 U.S.C. § 7525(b) (2000). The

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[13] Prior to 2004, subsection (b) referred to the definition of "tax shelter" found at 26 U.S.C. § 6662(d)(2)(C)(iii). As a result of amendments to § 6662, that definition is found now at 26 U.S.C.

plain text appears to apply to any tax shelter falling within the definition of a tax shelter found at 26 U.S.C. § 6662(d)(2)(C)(ii), and at least one district court has found that the tax shelter exception applies to individuals when the tax shelter required the participation of a corporation. *See Doe v. Wachovia Corp.*, 268 F. Supp. 2d 627 (W.D.N.C. 2003).

The Intervenors contend that subsection (b)'s heading, which, prior to the 2004 amendments, read "[s]ection not to apply to communications regarding corporate tax shelters," *see* 26 U.S.C. § 7525(b) (2000), demonstrated a clear congressional intent to limit subsection (b) to tax shelters for corporate income taxes. As a general rule, "[t]he title of a statute . . . cannot limit the plain meaning of the text." *Pennsylvania Dep't of Corr. v. Yeskey*, 524 U.S. 206, 212, 118 S. Ct. 1952, 141 L. Ed. 2d 215 (1998) (quoting *Bhd. of R.R. Trainmen v. Baltimore & Ohio R.R. Co.*, 331 U.S. 519, 528-29, 67 S. Ct. 1387, 91 L. Ed. 1646 (1943)) (internal quotation marks omitted) (omissions in original). A statute's heading is "of use only when [it] shed[s] light on some ambiguous word or phrase." *Yeskey*, 524 U.S. at 212 (quoting *Bhd. of R.R. Trainmen*, 331 U.S. at 529) (internal quotation marks omitted) (alterations in original). As noted above, subsection (b) is not ambiguous. If anything, the heading adds ambiguity to subsection (b). Absent this heading, the subsection would not seem limited to corporate tax shelters at all.

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§ 6662(d)(2)(C)(ii). For ease of analysis, we shall refer to the current code section.

Although the section heading suggests that Congress had corporate tax shelters in mind, "the fact that a statute can be applied in situations not expressly anticipated by Congress" demonstrates breadth, not ambiguity. *Yeskey,* 524 U.S. at 212 (quoting *Sedima, S. P. R. L. v. Imrex Co.,* 473 U.S. 479, 499, 105 S. Ct. 3275, 87 L. Ed. 2d 346 (1985)) (internal quotation marks omitted). The plain language of subsection (b) is certainly broad because it applies to "*any* written communication . . . in connection with the promotion of the direct or indirect participation of such corporation in *any* tax shelter," 26 U.S.C. § 7525(b) (2000) (emphasis added), but such breadth does not make the text ambiguous.

Further evidence of the intended breadth of the statute is found in its reference to the relatively broad "tax shelter" definition found in 26 U.S.C. § 6662(d)(2)(C)(ii) as opposed to the narrower definitions found in the pre-2004 version of 26 U.S.C. § 6111.[14] The definition of "tax shelter" found at 26 U.S.C. § 6662(d)(2)(C)(ii) defines a "tax shelter" as any partnership, entity, plan or arrangement, a significant purpose of which is the avoidance or evasion of Federal income tax. 26 U.S.C. § 6662(d)(2)(C)(ii).[15]

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[14] *See* supra note 1. It is worth noting that the American Jobs Creation Act of 2004 left the definition of "tax shelter" found in § 6662(d)(2)(C)(ii) unchanged.

[15] Prior to the 2004 amendments to the section, 26 U.S.C. § 6111 contained two definitions of "tax shelter" applicable only to § 6111. One of these definitions defined a "tax shelter" as certain investments for which the representations made in connection

Because subsection (b) is not ambiguous, we need not look to legislative history to determine its meaning. However, even if we were to consider legislative history, we would not find it useful because that history creates more ambiguity than it eliminates. Even the legislative history that the Intervenors cite in support of its argument that subsection (b) is limited to corporate taxes raises more questions than it answers. The Conference Report upon which the Intervenors rely states that the tax shelters to which subsection (b) applies "include, *but are not limited to,* those required to be registered as confidential corporate tax shelter arrangements under section 6111(d)." H.R. Rep. No. 105-599 at 269 (1998) (Conf. Rep.) (emphasis added). All this statement tells us is that the tax shelters referenced in subsection (b) reach a broader class of arrangements than the confidential corporate tax shelters then defined in § 6111(d). It says nothing of how much broader the exception is intended to sweep.

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with the sale of the investment would lead "any person" to believe that the investment would produce a "tax shelter ratio" over a threshold amount. 26 U.S.C. § 6111(c)(1) (2000). The other definition of "tax shelter" previously found in § 6111 defined "tax shelter" as any partnership, entity, plan or arrangement, a significant purpose of which is the avoidance or evasion of Federal income tax for a direct or indirect participant which is a corporation, that is offered under conditions of confidentiality, and for which the promoters receive commissions exceeding $ 100,000. *Id.* § 6111(d)(1). In contrast, 26 U.S.C. § 6662(d)(2)(C)(ii) makes no reference to dollar or "tax shelter ratio" thresholds, nor does it require the tax shelter to benefit a corporation.

The rest of the legislative history is equally unenlightening. Subsection (b) was added to the bill in conference committee and had not been part of the prior debate on the legislation. After subsection (b) was added, one of the key architects of the bill expressed concern that the privilege itself would lead to confusion and litigation. *See* 144 Cong. Rec. S7626 (daily ed. July 8, 1998) (statement of Sen. Moynihan). Confusion regarding the scope of the tax shelter exception was not limited to members of Congress; tax practitioners themselves expressed confusion as to the breadth of the tax shelter exception. *See* Sheryl Stratton, *Accountant-Client Privilege: Unclear from the Start,* 80 Tax Notes 7 (July 6, 1998).

Next, the Intervenors contend that the tax shelter exception applies only to communications "when the *corporation* is the *taxpayer.*" Intervenor's Br. at 20 (italics in original). According to the Intervenors, communication between a federally authorized tax practitioner and an S corporation's officers or agents in connection with the S corporation's participation in a tax shelter therefore would not fall within the tax shelter exception. The Intervenors assert that S corporations are not taxpayers and that "corporation" in this context means a C corporation.[16] *Id.* at 20-21.

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[16] A number of the Intervenors participated in BDO's programs through S corporations.

We cannot accept this argument. S corporations are both taxpayers and corporations under the IRC.[17] Although S corporations are not subject to taxes imposed by subtitle A, chapter 1 of the IRC, *see id.* § 1363(a), this exception merely means that they do not pay *directly* income taxes. Section 1363 does not exempt S corporations from other taxes imposed by the IRC, such as employment taxes (subtitle C) and excise taxes (subtitles D and E). Notably, the IRC defines "taxpayers" as "any person subject to *any* internal revenue tax." *Id.* § 7701(a)(14) (emphasis added).[18] This definition applies throughout the IRC, except when "otherwise distinctly expressed or manifestly incompatible" with the intent of the statute. *Id.* § 7701 (a). Section 7525 does not express distinctly any intent to define "taxpayer" only to include income tax payers, nor would it be "manifestly incompatible" with § 7525 to extend the tax practitioner privilege to advice given in connection with taxes other than income taxes.

Additionally, S corporations must calculate their taxable income, *id.* § 1363(b), and file a return, *id.*

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[17] If S corporations were not taxpayers, then the tax shelter exception is irrelevant, as the tax practitioner privilege applies only to "communication[s] between a taxpayer and any federally authorized tax practitioner." 26 U.S.C. § 7525(a)(1). If the S corporation is not a taxpayer, the S corporation has no privilege to assert with respect to communications between the S corporation's director, shareholder, officer, employee, agent or representative and a federally authorized tax practitioner.

[18] A corporation is a person for purposes of the IRC. *See* 26 U.S.C. § 7701(a)(1).

§ 6037(a). Further, the S corporation's taxable income is calculated in the same manner as an individual's, with certain exceptions which are not relevant here. *Id.* § 1363(b). Indeed, apart from non-separately computed income or losses, which are not relevant here, the S corporation calculates the income or losses passed through to its shareholders by calculating the S corporation's gross income and subtracting "the deductions allowed to *the corporation.*" *Id.* § 1366(a)(2) (emphasis added).

The Intervenors provide no support for their argument that the term "corporation," as used in § 7525(b) only means "C corporation." The IRC itself defines an S corporation as a "small business corporation for which an election under section 1362(a) is in effect," *id.* § 1361(a)(1); it defines a C corporation as "a corporation which is not an S corporation," *id.* § 1361(a)(2). This usage alone suggests that, when a particular section of the IRC is intended to apply only to C corporations, Congress will use that term, rather than the generic "corporation." Additionally, the IRC and implementing Treasury Regulations define "corporation" for federal tax purposes as "a business entity organized under a Federal or State statute . . . if the statute describes or refers to the entity as incorporated or as a corporation." 26 C.F.R. § 301.7701-2(b)(1).

The regulations relied upon by the Intervenors in support of their argument that "corporation," as used in subsection (b), means "C corporation" are inapposite. These regulations implement § 6111, which, as we have noted above, applies to a much narrower definition of "tax shelter" than the one

applied in subsection (b). Congress chose to define "tax shelter" for purposes of subsection (b) using a broader definition than that found in § 6111. However narrowly the cited regulations may confine the application of § 6111, they are of little relevance in defining the breadth of the definition found in 26 U.S.C. § 6662(d)(2)(C)(ii).[19]

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[19] The regulation to which the Intervenors refer, 26 C.F.R. § 301.6111-2, was promulgated prior to the 2004 amendments to § 6111 (the Intervenors actually cite the temporary regulations, but those regulations have since become permanent; the definition of confidential corporate income tax shelter in the permanent regulations is the same as that in the temporary regulations). Section 6111 was and remains an anti-fraud statute, aimed at providing the IRS with records of financial products marketed for the purpose of reducing Federal income tax liability. The pre-2004 version of § 6111 identified two types of transactions for special scrutiny as "tax shelters." *See* 26 U.S.C. § 6111(c) & (d) (2000). The first sort of transaction defined tax shelters generally as investments offered for sale that, based on the representations in connection with the offering, would lead a reasonable person to infer that the investment would generate deductions and credits exceeding statutorily defined ratio of deductions and credits to the adjusted basis of the initial investment. *See id.* § 6111(c). Further, the investment had to be a registered security or "substantial." *Id.* The second definition of "tax shelter" deemed confidential transactions, a significant purpose of which was the avoidance or evasion of corporate income taxes and for which the tax shelter's promoter may receive at least $ 100,000 in fees, to be tax shelters. *Id.* § 6111(d). As is evident from the first definition of "tax shelter" found in the pre-2004 version of § 6111, the section as a whole is not limited in its consideration to corporate tax shelters. The regulations the Intervenors cite implement the pre-2004 version

Finally, we address the Intervenors' contention that

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of § 6111 only with respect to the second definition of tax shelter, which was only one of the types of transactions identified by § 6111 as requiring special scrutiny. The current regulations continue to identify confidential corporate income tax shelters for purposes of implementing § 6111, even though § 6111 no longer uses the term "tax shelter."

Section 6662, on the other hand, is concerned with distinct issues. Section 6662 deals with penalties for underpayment of a taxpayer's tax liability. When an understatement of income is "substantial," § 6662 imposes a penalty of twenty percent of the amount of taxes underpaid. 26 U.S.C. § 6662(a)-(b). However, § 6662 provides that taxpayers may reduce the amount of an understatement, and hence the penalty imposed, by that portion of the understatement resulting from a position taken by the taxpayer for which there was substantial authority or, if the position is disclosed adequately on the tax return, for which there was a reasonable basis for such treatment. *Id.* § 6662(d)(2)(B). As an exception to this general rule, however, § 6662 provides that that portion of an understatement attributable to a tax shelter, i.e., a transaction into which the taxpayer enters, the substantial purpose of which is to avoid or evade income taxes, cannot be used to reduce the amount of the taxpayer's understatement, and hence the penalty imposed. *Id.* § 6662(d)(2)(B)(i). Thus, § 6662 reflects a congressional policy decision that understatements above a particular threshold, i.e., substantial understatements, merit penalties. It also has made the policy choice that certain positions taken on tax returns, i.e., those supported by substantial authority or, when properly disclosed, a rational basis, should not result in the taxpayer incurring penalties unless the position taken is the result of a transaction into which the taxpayer entered for the purpose of evading or avoiding taxes.

application of the tax shelter exception to tax shelters that do not involve corporate income taxes would "consume[] the general rule" by destroying the privilege any time a corporation participates in a tax shelter. Intervenors' Br. at 20. The Intervenors submit that, if the tax shelter exception extends to individual income taxes, any time a corporation, such as a banking corporation or investment corporation, is involved in the tax shelter, the general rule of tax practitioner privilege will be negated.

A close look at the tax shelter exception makes clear that the Intervenors' submission overstates significantly the scope of that exception. First, the exception applied only to written communications. Second, the written communication must have been between a federally authorized tax practitioner and a director, shareholder, officer, or employee, agent, or representative of a corporation. Third, the written communication must have been "in connection with the promotion of the direct or indirect participation of such corporation in any tax shelter," as defined in § 6662(d)(2)(C)(ii). 26 U.S.C. § 7525(b) (2000).

Because the exception is limited to written communications, oral communications between a tax practitioner and the corporate agent remain within the general rule of privilege. Further, because the tax shelter exception applies only when the written communication relates to the corporation's direct or indirect participation in a particular type of tax shelter, i.e., one meeting the definition found in § 6662(d)(2)(C)(ii), the tax shelter exception will not affect any otherwise privileged communication that

does not relate to a transaction falling within that definition.

Most importantly, the tax shelter exception applies only to communications between the tax practitioner and the corporate agent. As. noted earlier, the tax practitioner privilege is limited to communications that would be privileged if they had been made to an attorney.[20] The attorney-client privilege protects only those statements made by the client to the attorney in

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[20] We have held previously that this limitation means that non-lawyer tax practitioners cannot claim the privilege when "doing other than lawyers' work." *United States v. BDO Seidman*, 337 F.3d 802, 810 (7th Cir. 2003) (quoting *United States v. Frederick*, 182 F.3d 496, 502 (7th Cir. 1999)) (internal quotation marks omitted). This statement cannot be taken to mean that the tax practitioner privilege authorizes non-attorneys to engage in the practice of law when representing others before the IRS. By limiting the availability of the privilege to those individuals authorized to practice before the IRS subject to federal regulations and limiting the scope of the privilege to advice given within the individual's authority as a federally authorized tax practitioner, *see* 26 U.S.C. § 7525(a)(1), (3), § 7525 clearly is not intended to alter the scope of a federally authorized tax practitioner's authority to practice. Further, the regulations governing tax practitioners in activities before the IRS expressly state that nothing in the regulations shall "be construed as authorizing persons not members of the bar to practice law." 31 C.F.R. § 10.32. Taken in context, our prior observations on the scope of the privilege recognize nothing more than communications, though technically within the scope of practice before the IRS, that would fall outside of the attorney-client privilege are also outside of the tax practitioner privilege.

confidence. *See Evans,* 113 F.3d at 1462. A communication is not made in confidence when the client intends that the communication shall be disclosed to unprivileged third parties. *See* 2 Christopher B. Mueller & Laird C. Kirkpatrick, Federal Evidence § 186, at 324 (2d ed. 1994); *see also* Proposed Fed. R. Evid. § 503(a)(4), 56 F.R.D. 183, 236 (1972) ("A communication is 'confidential' if not intended to be disclosed to third persons other than those to whom disclosure is in furtherance of the rendition of professional legal services to the client or those reasonably necessary for the transmission of the communication."). However, an exception to this general rule permits disclosure of confidential communications by the attorney to an expert retained for the purpose of rendering legal services. 2 Mueller & Kirkpatrick, Federal Evidence § 186, at 324.

The tax practitioner privilege protects those communications which would be privileged if made to an attorney. *See* 26 U.S.C. § 7525(a). This protection is embodied both in the general rule regarding confidential communications and in the exception for disclosures to experts retained to assist the tax practitioner. With respect to individual income taxpayers, the tax shelter exception has the effect of taking communications intended to be passed along in written form to corporate agents in connection with the corporation's participation in a tax shelter out of the exception for communications to third party experts retained to assist the tax practitioner. Such communications are subject to the general rule that communications to third parties are not privileged. For all other confidential communications between the individual income tax payer and its tax practitioner,

both the general rule and the exception for communications to a retained expert apply.

Thus, we cannot accept the Intervenors' prediction that application of the tax shelter exception to individual income tax payers, as it relates to communications made before October 21, 2004, would swallow the general rule of tax practitioner privilege any time a corporation was involved in the shelter.

3. The District Court's Decision

We turn now to the district court's ruling that the tax shelter exception did not apply to the Intervenors' documents. It is unclear what legal standard the district court applied in assessing the applicability of the tax shelter exception to the communications at issue. The district court disposed of the matter in a footnote, in which it stated that, for the same reasons it found that the IRS' characterization of the Intervernors' conduct as falling within the crime-fraud exception, it did not find that the Intervenors engaged in tax shelters. *See* R.178 at 17 n.6. However, the tax shelter exception requires no showing of crime or fraud. Further, the record is unclear regarding what evidence, if any, was produced by the IRS to support its contention that the documents fell within the tax shelter exception. The IRS did contend that a significant purpose of the financial products purchased by the Intervenors was to avoid or evade federal income tax and the record reflects that some of the Intervenors had purchased the financial product through a corporation. R.135 at 11. However, the district court's decision does not indicate how these

allegations fell short of establishing the applicability of the tax shelter exception.

Additionally, the district court did not note which claims of privilege were sustained based on the attorney-client privilege and which were sustained based on the tax practitioner privilege. *See* R.178 at 13-14, 29. Because we cannot evaluate the legal standard employed by the district court, remand is necessary. *In re Grand Jury Proceedings (Thullen)*, 220 F.3d at 572. Thus, we must vacate the district court's ruling with respect to the applicability of the tax shelter exception and remand for further consideration.

On remand, for each of the 266 documents that the district court concluded to fall within a valid claim of privilege, the court should first determine whether the document falls within the attorney-client privilege, the tax practitioner privilege or both privileges. For those documents that would fall within the attorney-client privilege or both the attorney-client and tax practitioner privilege, no further analysis is required, as the tax shelter exception applies only to the tax practitioner privilege. *See* 26 U.S.C. § 7525(b) (2000). For those documents falling solely within the tax practitioner privilege, the burden rests upon the IRS to come forward with sufficient evidence to demonstrate some foundation in fact that a particular document falls within the tax shelter exception. To meet this burden, the IRS must bring forward evidence that: (1) the communication relates to a tax shelter, as defined by § 6662(d)(2)(C)(ii); (2) the communication was made by a director, shareholder, officer, or employee, agent, or representative of the corporation;

and (3) the communication was made in connection with the promotion of the direct or indirect participation of the corporation in such tax shelter.

Conclusion

For the forgoing reasons, the decision of the district court is affirmed in part and vacated and remanded in part.

AFFIRMED in part, VACATED and REMANDED in part.

APPENDIX B

UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS EASTERN DIVISION

No. 02 C 4822

[Filed August 30, 2005]

UNITED STATES OF AMERICA, Petitioner,	)
BDO SEIDMAN, LLP, Respondent,	)
and	)
ROBERT S. CUILLO, et. al., Intervenors.	)

MEMORANDUM OPINION AND ORDER

JAMES F. HOLDERMAN, District Judge:

On July 26, 2005, the Intervenors filed the pending motion pursuant to Rule 60 of the Federal Rules of Civil Procedure ("Rules"), for relief from this court's May 17, 2005 memorandum opinion and order. (Dkt. No. 191). For the reasons set forth below, this court denies the Intervenors' Rule 60 motion.

BACKGROUND

As discussed in greater detail in this court's March 30, 2005 and May 17, 2005 opinions, the Internal Revenue Service ("IRS" or "Government"), is currently investigating whether the accounting and consulting firm of BDO Seidman, LLP ("BDO"), sold allegedly unlawful tax shelters to BDO's clients ("Intervenors"). *United States v. BDO Seidman, LLP,* No. 02-4822, 2005 WL 1625002 (N.D. Ill. May 17, 2005); *United States v. BDO Seidman, LLP,* No. 02-4822, WL 742642 (N.D. Ill. Mar. 30, 2005). This court's March 30, 2005 opinion held that all but one of the 267 documents provided by the Intervenors for this court's *in camera* review were protected from disclosure to the IRS by the attorney-client privilege, the tax practitioner privilege and or the work product privilege. *BDO Seidman, LLP*, No. 02-4822, 2005 WL 742642, at *16. The one exception was document A-40 for which this court held a *prima facie* case had been established requiring the application of the crime-fraud exception to document A-40 and ordered additional briefing from the parties. *Id.* On May 17, 2005, this court held that the Intervenors had failed to meet their burden of providing a sufficient explanation to rebut this court's March 30, 2005 determination of a *prima facie* case for the application of the crime-fraud exception. The court therefore ordered that the Intervenors could not claim privilege to prevent the disclosure of document A-40 to the IRS. *BDO Seidman,* No. 02-4822, 2005 WL 1625002, at *1.

ANALYSIS

"Rule 60(b) relief is an extraordinary remedy and is granted only in exceptional circumstances." *Karraker v. Rent-A-Center, Inc.*, 411 F.3d 831, 837 (7th Cir. 2005) (quoting *Cincinnati Ins. Co. v. Flanders Elec. Motor Serv. Inc.*, 131 F.3d 625, 628 (7th Cir. 1997)). "[T]he movant bears the burden of showing that extraordinary circumstances exist which warrant vacating" the earlier order. *Neuberg v. Michael Reese Hosp. and Med. Ctr.*, 166 F.R.D. 398, 399 (N.D. Ill. 1996) (citing *Industrial Assoc., Inc v. Goff Corp.*, 787 F.2d 268, 269 (7th Cir. 1986)). The Seventh Circuit reviews a district court's Rule 60(b) decisions under an abuse of discretion standard. *Easley v. Kirmsee*, 382 F.3d 693, 697 (7th Cir. 2004) *(Castro v. Bd. of Educ.*, 214 F.3d 932, 934 (7th Cir. 2000)).

The Intervenors argue that this court should reexamine its rulings on document A-40 in light of the Second Circuit's decision in *Denney v. BDO Seidman, LLP*, 412 F.3d 58 (2d Cir. 2005). The Second Circuit's on June 14, 2004 reversed the decision by the Southern District of New York in *Denney*. *Denney v. Jenkens & Gilchrest*, 340 F. Supp. 2d 338 (S.D.N.Y. 2004), *rev'd Denney v. BDO Seidman, LLP*, 412 F.3d 58 (2d Cir. 2005).

The Intervenors' pending Rule 60 motion mischaracterizes the court's March 30th and May 17th opinions and the role that the Southern District of New York's *Denney* opinion played in this court's determination. This court did not rely on the Southern District of New York's *Denney* decision as controlling case law in either the March 30th or May 17th opin-

ions. The reversing of the Southern District of New York's decision in *Denney* does not effect the controlling case law that this court followed in this case, which was the controlling law of the Supreme Court and the Seventh Circuit along with case law from the Northern District of Illinois. *See BDO Seidman, LLP,* No. 02-4822, 2005 WL 742642, at *8 (citing *United States v. Zolin,* 491 U.S. 554, 569 (1989); *United States v. Davis,* 1 F.3d 606, 609 (7th Cir. 1993); *United States v. Segal,* No 02 CR 112, 2004 WL 830428 (N.D. Ill. Apr. 16, 2004); *Vardon Golf Co., Inc. v. Karsten Mfg. Corp.,* 213 F.R.D. 528, 535 (N.D. Ill. 2003); *Pandick Inc. v. Rooney,* No. 85 C 6779, 1988 WL 6110 (N.D. Ill. June 2, 1988)).

The controlling standard of the Seventh Circuit in this case for the application of the crime-fraud exception requires: "(1) a *prima facie* showing of [a crime or] fraud, and (2) the communications in question are in furtherance of the misconduct." *BDO Seidman, LLP,* No. 02- 4822, 2005 WL 742642, at *8 (quoting *Vardon Golf Co., Inc. v. Karsten Mfg. Corp.,* 213 F.R.D. 528, 535 (N.D. Ill. 2003); *Pandick Inc.* v. *Rooney,* No. 85 C 6779, 1988 WL 6110 (N.D. Ill. June 2, 1988)). As this court has previously stated, the Seventh Circuit's explanation in *United States v. Davis* provides the proper method for analyzing the crime-fraud exception:

> [T]o drive away the privilege ... there must be something to give colour to the charge; there must be *prima facie* evidence that it has some foundation in fact. When the evidence is supplied, the seal of secrecy is broken. [The Seventh Circuit has] also noted that *prima facie*

> evidence did not mean enough to support a verdict in favor of the person making the claim. Instead [the Seventh Circuit has] held that a party has established a *prima facie* case whenever it presents evidence sufficient to require the adverse party, the one with superior access to the evidence and in the best position to explain things, to come forward with that explanation. [The Seventh Circuit has] also stated that if the district court finds such an explanation satisfactory the privilege remains and that the district court's decisions regarding these matters may be disturbed only for an abuse of discretion.

BDO Seidman, LLP, No. 02-4822, 2005 WL 742642, at *8 (citing 1 F.3d 606, 609 (7th Cir. 1993) (internal quotations and citations omitted)).

The Intervenors also argue that "the *Denney* reversal is particularly relevant because it was the only case of the three cited by this Court ... where fraud was found to occur." (Dkt. No. 191 at ¶ 21). The problem in the Intervenors' reasoning is that the application of the crime-fraud exception by this court is not based an other court's finding of the existence of a crime or fraud. The standard is "(1) a *prima facie* showing of [a crime or] fraud, and (2) the communications in question are in furtherance of the misconduct." *BDO Seidman, LLP*, No. 02-4822, 2005 WL 742642, at *8 (quoting *Vardon Golf Co., Inc. v. Karsten Mfg. Corp.*, 213 F.R.D. 528, 535 (N.D. Ill. 2003); *Pandick Inc. v. Rooney*, No. 85 C 6779, 1988 WL 6110 (N.D. Ill. June 2, 1988)). "*Prima facie* evidence [does] not mean enough to support a verdict in favor of the person

making the claim. Instead, ... a party has established a *prima facie* case whenever it presents evidence sufficient to require the adverse party, the one with superior access to the evidence and in the best position to explain things, to come forward with that explanation." *BDO Seidman, LLP*, No. 02-4822, 2005 WL 742642, at *8 (citing 1 F.3d 606, 609 (7th Cir. 1993) (internal quotations and citations omitted))

This court's March 30, 2005 opinion held only that a *prima facie* showing had been made for the application of the crime-fraud exception for document A-40. This court *did not* hold that BDO or the Intervenors had engaged in a crime or fraud. In fact, this court noted that "[t]he question of whether the Intervenors and BDO engaged in unlawful activity, or [alternatively] properly complied with the tax code, is one of the ultimate questions for this litigation." *BDO Seidman, LLP,* No. 02-4822, 2005 WL 742642, at *9. The court's determination on March 30, 2005 was "that a *prima facie* case for the application of the crime--fraud exception" had been established for document A-40 and therefore shifted the burden to the Intervenors, as the party with the "superior access to the evidence and in the best position to explain things, to come forward with that explanation," *United States v. Davis*, 1 F.3d 606, 609 (7th Cir. 1993) (internal quotations and citations omitted), if they wished to rebut the *prima facie* finding. *BDO Seidman, LLP,* No. 02-4822, 2005 WL 742642, at *16.[1]

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[1] The importance of what the court did and *did not* find in its March 30, 2005 opinion is highlighted by the Intervenors' comment that "an erroneous finding that a reputable public

This court, after considering the parties' arguments and the existing case law, identified eight "Potential Indicators of Fraud that the Court Looked for During the *In Camera* Review of the Submitted Documents" in its March 30, 2005 decision. *BDO Seidman, LLP,* No. 02-4822, 2005 L 742642, at *12.

This court was clear to point out that although the court considered the eight indicators to be:

> potential indicators of fraud when it performed the *in camera* review[,] ... [tlhe court [did] not limit itself to the indicators in determining whether a *prima facie* case [existed] for the application of the crime-fraud exception. Instead this court looks to the "totality of the circumstances," *United States v. BDO Seidman LLP*, No. 02 C 4822, 2002 WL 32080709 (7th Cir. Dec. 18, 2002), surrounding each document in order to determine whether there is "something to give colour to the charge ... so as to

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accounting firm such as BDO engaged in a crime or fraud could eventually lead to 'Arthur Andersen' type results, where the organization was ruined and tens of thousands of employees lost their jobs. This risk and danger of a hasty judgment is identifiable in the aftermath of the Supreme Court's recent reversal of the Arthur Andersen conviction." (Dkt. No. 191 at ¶ 27) (internal citations omitted). This court clearly noted in its March 30, 2005 opinion that it was finding a *prima facie* case for the application of the crime-fraud exception for document A-40 and that finding is of a lower threshold since it does "not mean enough to support a verdict in favor of the person making the claim." *BDO Seidman, LLP,* No. 02-4822, 2005 WL 742642, at *8.

> require the [Intervenors], the one[s] with superior access to the evidence and in the best position to explain things, to come forward with that explanation." *United States v. Davis*, 1 F.3d 606, 609 (7th Cir. 1993) (internal quotations and citations omitted). Furthermore, it is important to note that an indication of potential fraud does not mean that fraud exists sufficient for a *prima facie* finding. These factors are merely guideposts to assist this court in its *in camera* review.

BDO Seidman, LLP, No. 02-4822, 2005 WL 742642, at *12.

The Intervenors' Rule 60 motion improperly labels the eight Potential Indicators to be the "eight-factor *test* to determine whether indicia of potential fraud are sufficient for purposes of establishing the *prima facie* case." (Dkt. No. 191 at ¶ 12) (emphasis added). The eight potential indicators of fraud used by this court were "merely guideposts to assist this court in its *in camera* review," not the controlling "test," as incorrectly suggested by the Intervenors. *BDO Seidman, LLP*, No. 02-4822, 2005 WL 742642, at *12. The court looked not just to the eight identified potential indicators of fraud but to "the totality of the circumstances surrounding each document in order to determine whether there is something to give color to the charge so as to require the Intervenors, the ones with superior access to the evidence and in the best position to explain things, to come forward with that explanation." *Id.* (internal quotations and citations omitted).

The Intervenors' final argument challenges the court's May 17, 2005 opinion in which this court held that the Intervenors had failed to meet their burden of rebutting the court's finding of a *prima facie* case for the application of the crime-fraud exception for document A-40. This court clearly stated in its March 30, 2005 opinion that the burden was shifted to the Intervenors "to come forward with an explanation as to why [document A-40] should not be disclosed to the government under the crime-fraud exception." *BDO Seidman, LLP*, No. 02-4822, 2005 WL 742642, at *16. The Intervenors were put on notice that they needed to provide an explanation to rebut the court's March 30, 2005 finding and they failed at that task. Nothing in their Rule 60 motion remedies that failure.

CONCLUSION

The Intervenors' Rule 60 motion of July 26, 2005 for relief from this court's May 17, 2005 memorandum opinion and order (Dkt. No. 191), is denied.

ENTER:

/s/
JAMES F. HOLDERMAN
United States District Judge

DATE: August 30, 2005

APPENDIX C

UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION

No. 02 C 4822

[Filed May 17, 2005]

UNITED STATES OF AMERICA, Petitioner,	)
v.	)
BDO SEIDMAN, LLP, Respondent,	)
and	)
ROBERT S. CUILLO, et. al., Intervenors.	)

MEMORANDUM OPINION AND ORDER

JAMES F. HOLDERMAN, District Judge:

As this court discussed in greater detail in its March 30, 2005 memorandum opinion and order, ("March 30, 2005 opinion"), the Internal Revenue Service ("IRS" or "Government"), is currently engaged

in an investigation into whether the accounting and consulting firm BDO Seidman, LLP ("BDO"), sold allegedly abusive tax shelters to BDO's clients, ("Intervenors"). (Dkt. Nos. 177, 178); *United States v. BDO Seidman, LLP,* 2005 U.S. Dist. LEXIS 5555, No. 02 C 4822, 2005 WL 742642 (N.D. Ill. Mar. 30, 2005). This court's March 30, 2005 opinion held that all but one of the 267 documents provided by the Intervenors for this court's *in camera* review were protected from disclosure to the IRS by the attorney-client privilege, tax practitioner privilege and or work product doctrine. 2005 U.S. Dist. LEXIS 5555, [WL] at* 15. For the one exception, document A-40, this court held that it had determined through its *in camera* review of document A-40 that a *prima facie* case existed for the application of the crime-fraud exception.2005 U.S. Dist. LEXIS 5555, [WL] at * 16.

This court ordered additional briefing from the parties to determine whether Intervenor Robert Cuillo, or any other Intervenors wishing to assert privilege over the document, should be denied the application of privilege for document A-40 under the crime-fraud exception. For the reasons set forth below, this court holds that the Intervenors have failed to provide sufficient explanation to rebut this court's finding of a *prima facie* case for the application of the crime-fraud exception for document A-40. Consequently, this court holds that the crime-fraud exception must be applied to document A-40, and therefore a claim of privilege cannot be used to prevent the disclosure of document A-40 to the IRS under the IRS's civil subpoenas.

BACKGROUND

A primary argument advanced by the IRS in this litigation is that BDO and the Intervenors cannot seek the benefit of the attorney-client privilege, tax practitioner privilege or the work product doctrine because BDO and the Intervenors were engaged in the fraudulent activity of using illegal tax shelters and hiding that activity from the IRS. The IRS has continually argued that this alleged illegal activity prevents the application of any privilege to the 267 Intervenor documents, including document A-40, that this court reviewed during the summer and fall of 2004. The IRS made similar arguments when this court performed an *in camera* review of 110 BDO documents during the spring and summer of 2004. *United States v. BDO Seidman, LLP,* 2004 U.S. Dist. LEXIS 12145, No. 02-4822, 2004 WL 1470034 (N.D. Ill. June 28, 2004).

This court rejected the IRS' broad assertion that BDO and the Intervenors were denied the right to assert privilege under the crime-fraud exception when this court considered the 110 BDO documents in June 2004, No. 02-4822, 2004 U.S. Dist. LEXIS 12145, [WL] at *4, and the 267 Intervenor documents in March 2005. No. 02 C 4822, 2005 U.S. Dist. LEXIS 5555, [WL], at *9. The blanket application of the crime-fraud exception would be inappropriate because this court characterized much of the IRS' arguments as being based on "speculation and innuendo." No. 02 C 4822,2005 U.S. Dist. LEXIS 5555, [WL] at *9; No. 02-4822, 2004 U.S. Dist. LEXIS 12145, [WL] at *4. The fact that the IRS has characterized a transaction as abusive and unlawful does not mean that the characterization is proper as a matter of law when consider-

ing whether to apply the crime-fraud exception. No. 02 C 4822, 2005 U.S. Dist. LEXIS 5555, 2005 WL 742642, at *9. Furthermore, in light of the complexity and uncertainties of the IRS code, the fact that determining whether the involved transactions are in fact unlawful is one of the ultimate questions of this litigation, and the lack of evidence presented by the IRS to that point in the litigation, this court's March 30, 2005 opinion held that "[a] determination by this court that BDO and the Intervenors engaged in fraudulent and criminal activity ... would be premature and would place the proverbial 'Cart before the Horse.'" *Id.*

This court did, however, in both its June 28, 2004 and March 30, 2005 opinions, consider whether the crime-fraud exception should be applied on a document-by-document basis when the court performed its *in camera* review. In its June 28, 2004 memorandum opinion and order, ("June 28, 2004 opinion"), this court held that there was no evidence to substantiate the application of crime-fraud exception to the 110 BDO documents. In its March 30, 2005 opinion on the 267 Intervenor documents, this court held that there was only sufficient evidence to support a *prima facie* finding for the application of the crime-fraud exception to one document, document A-40. The March 30, 2005 opinion instructed the parties to submit additional briefing on document A-40. The present memorandum opinion and order addresses the additional briefing presented by the parties on the question of whether the crime-fraud exception should be applied to document A-40.

ANALYSIS

As this court stated in its March 30, 2005 opinion, "under the crime-fraud exception, communications that would otherwise be protected by the attorney-client privilege, [as well as the tax practitioner privilege], lose their protected status if they were 'made for the purpose of getting advice for the commission of a fraud or crime.'" No. 02 C 4822, 2005 U.S. Dist. LEXIS 5555, [WL] at *8 (citing *United States v. Segal,* 2004 U.S. Dist. LEXIS 6616, No. 02 CR 112, 2004 WL 830428, at *1 (N.D. Ill. Apr. 16 2004) (quoting *United States v. Zolin,* 491 U.S. 554, 563, 105 L. Ed. 2d 469, 109 S. Ct. 2619 (1989))). "'The crime-fraud exception applies where the party attempting to circumvent the privilege, [in the present case the IRS,] can meet the following test: (1) a *prima facie* showing of [a crime or] fraud, and (2) the communications in question are in furtherance of the misconduct.'" No. 02 C 4822, 2005 U.S. Dist. LEXIS 5555, [WL] at *8 (citing *Vardon Golf Co., Inc. v. Karsten Mfg. Corp.,* 213 F.R.D. 528, 535 (N.D. Ill. 2003) (citing *Pandick, Inc. v. Rooney,* 1988 U.S. Dist. LEXIS 5436, No. 85 C 6779, 1988 WL 61180, at *2 (N.D. Ill. June 2, 1998))).

As this court also stated in its March 30, 2005 opinion, the Seventh Circuit in *United States v. Davis* has explained the application of the crime-fraud privilege as follows:

> [To drive away the privilege ... there must be something to give colour to the charge; there must be *prima facie* evidence that it has some foundation in fact. When the evidence is supplied, the seal is broken. [The Seventh Circuit

> has] also noted that *prima facie* evidence did not mean enough to support a verdict in favor of the person making the claim. Indeed [the Seventh Circuit has] held that a party has established a *prima facie* case whenever it presents evidence sufficient to require the adverse party, the one with superior access to the evidence and in the best position to explain things, to come forward with that explanation. [The Seventh Circuit has also] stated that if the district court finds such an explanation satisfactory the privilege remains and that the district court's decisions regarding these matters may be disturbed only for an abuse of discretion.

No. 02 C 4822, 2005 U.S. Dist. LEXIS 5555, [WL] at *8 (citing 1 F.3d 606, 609 (7th Cir. 1993)(internal citations omitted)).

In order to guide this court's *in camera* evaluation of the 267 documents when considering whether a *prima facie* case for the crime-fraud exception had been established, this court identified eight potential indicators of potential fraud. No. 02 C 4822, 2005 U.S. Dist. LEXIS 5555, [WL] at *12. The court developed these indicators based on the arguments presented in the parties' briefs, evidence presented by the parties through declarations and supporting documents, and a review of the related cases of *Denney v. Jenkens & Gilchrist,* 340 F. Supp. 2d 338 (S.D.N.Y. 2004), *Miron v. BDO Seidman, LLP,* 342 F. Supp. 2d 324 (E.D. Pa. 2004), and *United States v. KPMG,* 316 F. Supp. 2d 30 (D.D.C. 2004). These eight indicators of potential fraud are: (1) the marketing of pre-packaged transactions by BDO; (2) the communication by the Intervenors to

BDO with the purpose of engaging in a pre-arranged transaction developed by BDO or third party with the sole purpose of reducing taxable income; (3) BDO and/or the Intervenors attempting to conceal the true nature of the transaction; (4) knowledge by BDO, or a situation where BDO should have known, that the Intervenors lacked a legitimate business purpose for entering into the transaction; (5) vaguely worded consulting agreements; (6) failure by BDO to provide services under the consulting agreement yet receipt of payment; (7) mention of the COBRA transaction; and (8) use of boiler-plate documents. No. 02 C 4822, 2005 U.S. Dist. LEXIS 5555, [WL] at *12.

This court was clear to point out in its March 30, 2005 opinion that its *in camera* review on the question of whether a *prima facie* showing for the application of the crime-fraud exception was not limited to these eight factors. "The court does not limit itself to the indicators in determining whether a *prima facie* case for the application of the crime-fraud exception. Instead, this court looks to the 'totality of the circumstances,' *United States v. BDO Seidman, LLP,* 2002 U.S. App. LEXIS 28092, No. 02 C 4822, 2002 WL 32080709 (7th Cir. Dec. 18, 2002), surrounding each document in order to determine whether there is 'something to give colour to the charge ... so as to require the [Intervenors], the one[s] with superior access to the evidence and in the best position to explain things, to come forward with that explanation.' *United States v. Davis,* 1 F.3d 606, 609 (7th Cir. 1993) (internal quotations and citations omitted). Furthermore, its important note that an indication of potential fraud does not mean that fraud exists sufficient for a *prima facie* finding. These factors are merely guide-

posts to assist this court in its *in camera* evaluation." No. 02 C 4822, 2005 U.S. Dist. LEXIS 5555, [WL] at *12.

The Intervenors's present position is that document A-40 is not communication in furtherance of a crime or fraud, but was part of the common financial planning activity of selling off investments towards the end of a year in order to take advantage of tax savings. According to the Intervenors' April 14, 2005 memorandum, Intervenors including Intervenor Cullio, invested in a portfolio of emerging market distressed debt and then sought to sell that debt at the end of a year to lessen their tax liability. (Dkt. No. 181 at pg. 2-3). According to the Intervenors' brief, there is no fraud or crime in this behavior, but instead this is a common financial planning activity performed by "every stock broker, financial planner, tax advisor and investor in America" at the end of every year. *Id.* at pg. 4.

The government counters that document A-40 is not part of legitimate year-end tax planning, but instead is part of the overall abusive sham tax shelter transaction perpetrated by BDO and invested in by Intervenor Cullio and others. The government provides the Fifth Supplemental Declaration from IRS Revenue Agent Sandra Alevlo ("Alevlo"), in support of its position and the Alevlo's declaration in turn is supported by a variety of documents previously obtained by the IRS from BDO and the Intervenors related to the distress debt transaction. (Dkt. No. 185).

Upon review of the parties' submissions, this court holds that the Intervenors have failed to meet their burden of providing a satisfactory explanation as to

why document A-40 should not be disclosed under the crime-fraud exception. The Intervenors, the party "with superior access to the evidence and in the best position to come forward" with an explanation that rebuts the finding of the *prima facie* case for the application of the crime-fraud exception, have failed to meet their burden of providing a sufficient explanation to rebut this court's March 30, 2005 finding for a *prima facie* case for the application of the crime-fraud exception for document A-40. No. 02 C 4822, 2005 U.S. Dist. LEXIS 5555, [WL] at *8 (citing *United States v. Davis*, 1 F.3d 606, 609 (7th Cir. 1993) (internal citations omitted)).

The government's position, as supported by Revenue Agent Alvelo's declaration, is substantially more comprehensive, complete and believable in comparison to the Intervenor's position. If there was no burden placed on either party, the court would be more likely to believe the government's position on this matter. In light of the fact that the burden is on the Intervenors, the party with greater access to information, the Intervenors' inability to provide a valid non crime-fraud explanation becomes even more acute.

The Intervenors' position does not prevail here for several reasons. First, the Intervenors present the position that Intervenor Cullio was merely selling off assets in which he had previously invested in order to take advantage of the loss for tax purposes. However, this position would require Intervenor Cullio to have previously invested in the assets, presumably hoping to turn a profit thereon, the investment had not provided for a profit and that Intervenor Cullio was

merely trying to salvage a tax advantage from his failed investment.

However, based on the information provided through Revenue Agent Alvelo's declaration and supporting materials, it appears that the immediate activity in transaction was for Cullio to obtain a loss. The initial investment in the distressed debt appears to have occurred in late 2001, the same period in which Cullio was looking to receive the loss. This contradicts other materials previously provided by the Intervenors in which they claim that their primary purpose for investing in these transactions was the hope of making a profit.

The court's initial conclusion that Intervenor Cullio appeared only to be interested in obtaining a loss is supported by the memorandum written by Michael Kerekes dated May 2, 2001 and included as government exhibit A-57 in support of Revenue Agent Alvelo's declaration. Kerekes states in the memorandum that one of the issues in the distressed debt transaction is "whether the debt is subject to a marking-to-market requirement under IRC § 475, *which would of course render it useless for our purposes.*" (Dkt. No. 185, Gov't Ex. A-57 (emphasis added)).

Marking a security to market value requires the revaluing of the security from its book value to fair market value. (For a general discussion of accounting concept of mark to market and IRC § 475 *see Bank One Corp. v. Commissioner*, 120 T.C. 174, 2003 WL 2012540 (T.C. 2003)). The effect of the "marking-to-market" on "distressed debt" would mean the elimina-

tion of a potential deductible tax loss. The key to the court is the statement in Kerekes' memorandum that the application of mark to market, and thus the elimination of the potential tax loss, "would of course render it [the distressed debt] unless for our purposes." (Dkt. No. 185, Gov't Ex. A-57).

The court must acknowledge, of course, that investing in a debt security for the potential tax advantages is not by itself a crime or fraud. The Intervenors are correct in their assertion that it is a normal practice for individuals to liquidate their investments to take advantage of losses for tax purposes. The problem in this case, however, is that the Intervenors have failed to provide any explanation in their briefs or supporting documentation to overcome the government's position that this particular transaction is in violation of the Internal Revenue Code.

Furthermore, this is the first time that the government has presented documentation in which a BDO employee states that the sole purpose of the activity is to obtain a loss. In other documents discussing the other transactions the court previously reviewed *in camera*, such as opinion letters, engagement letters and client representations, there were assertions from BDO and the Intervenors that one of the primary purposes for the transaction was to make a profit. In reviewing the government's prior assertions about the nature of the BDO transactions, the court found itself unable to move beyond the fact that the documents the court was reviewing *in camera* included statements that there was a profit motive and therefore there was evidence that contradicted the government's position that the sole motive of the BDO transactions was to

create losses so as to evade income tax. The May 2, 2001 Kerekes memorandum is the first time that this court has identified evidence which appears to suggest that the sole motive was to obtain a loss.

The court wishes to be clear that this memorandum opinion and order is limited to the question of whether the crime-fraud exception eviscerates the Intervernors' privilege claim on document A-40. The court is not reexamining its June 28, 2004 and March 30, 2005 opinions in which the court rejected the government's broader position that everything done by BDO and the Intervenors is unlawful and that the apparently legitimate activities are merely a ruse to cover up the alleged unlawful activity. The court singled out document A-40 because it appeared to this court, "under the totality of the circumstance," *United States v. BDO Seidman, LLP,* 2002 U.S. App. LEXIS 28092, No. 02 C 4822, 2002 WL 32080709 (7th Cir. Dec. 18, 2002), that there was sufficient evidence for a finding of a *prima facie* case of the crime-fraud exception. Because of that, the appropriate procedure was to shift the burden to the Intervenors to bring forward a valid explanation since the Intervenors are the ones "with superior access to the evidence and in the best position to explain things." No. 02 C 4822, 2005U.S. Dist. LEXIS 5555, [WL] at *8 (citing 1 F.3d 606, 609 (7th Cir. 1993) (internal citations omitted)). The Intervenors have failed to meet this burden and therefore the only explanation that the court has for document A-40 is the government's position. The larger issue of whether the overall activities of BDO and the Intervenors are lawful or unlawful remain for investigation by the IRS and potential future litigation between the parties.

CONCLUSION

For the reasons stated herein, this court holds that Intervenors have failed to provide sufficient explanation to rebut this court's finding of a *prima facie* case for the application of the crime-fraud exception for document A-40. Consequently, this court holds that the crime-fraud exception must be applied to document A-40 and therefore a claim of privilege cannot be used to prevent the disclosure of document A-40 to the IRS under the IRS's civil subpoenas. The Intervenors are to disclose document A-40 forthwith to government counsel. This case is set for a report on status on May 31, 2005.

ENTER:

JAMES F. HOLDERMAN

United States District Judge

DATE: May 17, 2005

APPENDIX D

UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS EASTERN DIVISION

No. 02 C 4822

[Filed March 30, 2005]

UNITED STATES OF AMERICA, Petitioner,	)
v.	)
BDO SEIDMAN, LLP, Respondent,	)
and	)
ROBERT S. CUILLO, et. al., Intervenors.	)

MEMORANDUM OPINION AND ORDER

JAMES F. HOLDERMAN, District Judge:

On July 9, 2002, the Internal Revenue Service ("IRS"), filed a petition with the court to enforce twenty civil summonses served on BDO Seidman, LLP, ("BDO"), a public accounting and consulting firm.

(Dkt.No. 1.) The summonses are part of an IRS investigation into BDO's potential involvement in allegedly abusive tax shelters. BDO and a number of BDO's clients ("Intervenors"), asserted a variety of privilege claims in response to the IRS summonses. This court has previously held that the federally authorized tax practitioner privilege, ("tax practitioner privilege"), I.R.C. § 75251[1], does not prevent the disclosure of the Intervenors' identities, *United States v. BDO Seidman, LLP*, 2003 U.S. Dist. LEXIS 1634, No. 02 C 4822, 2003 WL 932365 (N.D. Ill. Feb. 5, 2003), *aff'd*, 337 F.3d 802 (7th Cir. 2003), *cert. denied sub nom.* 540 U.S. 1178, 158 L. Ed. 2d 78, 124 S. Ct. 1410 (2004), and that the attorney-client privilege and the work product doctrine protected BDO from disclosing 104 documents to the IRS. *United States v. BDO Seidman, LLP*, 2004 U.S. Dist. LEXIS 12145, No. 02 C 4822, 2004 WL 1470034 (N.D. Ill June 29, 2004).

The Intervenors withheld from the IRS' scrutiny 267 documents on the asserted basis that the documents are privileged under the tax practitioner privilege, set forth in 26 U.S.C. § 7525, the common law attorney-client privilege as well as the work product doctrine. Pursuant to this court's order of July 15, 2004, (Dkt. No. 131), the Intervenors have submitted a privilege log identifying the privilege assertion for each of the 267 withheld documents and have submit-

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[1] Statutory citations to "I.R.C." are to the Internal Revenue Code, Title 26 of the United States Code.

ted copies of the withheld documents themselves for this court's *in camera* review.[2]

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[2] The documents and an associated privilege log were submitted on July 29, 2004 for *in camera* review by Intervenors Robert S. Cuillo, Gary Ervin, Robert Ervin, Timothy Ervin, Richard Garman and Johnna Coats, Chand Gupta, DRG Irrevocable Trust, DSG Irrevocable Trust, Jai N. Gupta, Jai N. Gupta Revocable Trust, Ram Gupta, Shashi A Gupta, Shashi A Gupta Revocable Trust, Billy L. "Dwayne" Hawkins, Shahid Khan, Ray Lane, R.K. Lowry, Jr., John P. Moffitt, Arlene Nussdorf, Glenn Nussdorf and Claudine Strum, Glenn Nussdorf Trust, Ruth Nussdorf, Stephen and Alicia Nussdorf, Stephen Nussdorf Trust, Quality King. The Intervenors in their brief of August 12, 2004 categorize the documents submitted for *in camera* review as opinion letters, memorandum, drafts of opinion letters and memorandum, handwritten notes, emails, faxes, letters, summaries, type written notes and schedules.

The documents were divided and identified with a unique document code for tracking purposes. For example, the first document for Robert S. Cuillo was given a document code of "A-1," the second document for Robert S. Cuillo had a document code of "A-2," and so forth. Documents for Gary Ervin are labeled "B-xx," Robert Ervin documents are "C-xx," and so forth with a new letter assigned to each Intervenor. Each page submitted also included an individual Bates number.

The privilege log is presented in chart format with the following columns: Doc. Code, Intervenor Last Name, Intervenor First Name, Bates Range, Doc. Date, Document Type, No. Pgs., Author, Author's Employer / Position, Addressee, Addressee's Employer / Position, Copies Provided To, Why Document Created, Grounds.

This court has carefully reviewed each of the 267 withheld documents *in camera* and considered each of the arguments presented by each of the parties. For the reasons set forth below, this court finds that the withheld documents submitted by the Intervenors are each privileged with the exception of the document identified as A-40 in which this court finds a *prima facie* showing of the crime-fraud exception has been made. The Intervenors do not have to disclose the withheld documents that this court has found to be privileged to the IRS.[3]

BACKGROUND

The IRS filed a petition on July 9, 2002 pursuant to I.R.C. §§ 7402 (b) and 7604(a) seeking judicial enforcement of twenty civil summonses served on BDO as part of an IRS investigation into whether BDO may be

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Intervenors R.K. Lowry, Jr. and John P. Moffitt, provided two additional documents for *in camera* review. (Dkt. Nos. 137,138.) Intervenors Gary Ervin, Timothy Ervin, Robert Ervin, Chand Gupta, DSG Irrevocable Trust, Ram Gupta and DRG Irrevocable Trust withdrew their privilege claims and the remaining Intervenors provided an amended privilege log on September 10, 2004. (Dkt Nos. 141,142.) The government was granted leave to file a sur-reply, with a final reply from the remaining Intervenors, to address what impact, if any, the withdrawal of the intervenors had on the remaining Intervenors' privilege claims. (Dkt. No. 144).

[3] In issuing this opinion, the court has considered the additional authority provided by the parties after the completion of briefing including the Government's Motion for Leave to Cite Additional Authority filed on March 15, 2005.

liable under I.R.C. §§ 6707 and 6708 for promoting abusing tax shelters from 1995 through 2002. (Dkt. No. 1). BDO challenged the summonses arguing the following: (1) that the investigation did not have a legitimate purpose, (2) the summonses were overbroad and issued in bad faith, and, (3) that the requested information was already in IRS' possession or the information was not relevant to the investigation. *United States v. BDO Seidman, LLP*, 337 F.3d 802, 806 (7th Cir. 2003). BDO also asserted tax practitioner privilege under I.R.C. § 7525 by providing two privilege logs, one log 86 pages long listing 826 documents, and the other 42 pages long listing 293 documents. *United States v. BDO Seidman, LLP*, 225 F. Supp. 2d 918, 920 (N.D. Ill. 2002) (Shader, J.). Judge Shader ruled in October 2002 that the IRS had met its burden of showing that the summonses were issued in good faith and BDO had failed to show that the enforcement of the summonses would constitute an abuse of discretion. 337 F.3d at 806 (citing 225 F. Supp. 2d at 920). Judge Shader ordered BDO to produce all documents required under the summonses except for the 1119 documents that had been previously submitted for *in camera* review. Judge Shader referred to Magistrate Judge Ashman the responsibility of performing a document-by-document *in camera* review of the 1119 documents where BDO had asserted the tax practitioner privilege.

After Judge Shader's first opinion, a group of BDO client sought to intervene into the case. 337 F.3d at 807. BDO had informed a certain number of its clients that it would be producing documents to the IRS, and in turn these clients became concerned that their identity would be revealed to the IRS. *Id.* Two sets of

BDO clients, John and Jane Does ("Does"), and Richard and Mary Roes ("Roes"), filed an emergency motion with the district court to intervene in the proceeding pursuant to Rule 24(a)(2) of the Federal Rules of Civil Procedure ("Rules"). (*Id.*) BDO's clients argued that the disclosure of their identity would violate the tax practitioner privilege under I.R.C. § 7525, but acknowledged that there was nothing privileged in the contents of the documents that BDO was attempting to turnover to the IRS. (*Id.*) Judge Shader denied the Does and Roes' motion to intervene on November 1, 2002, (Dkt. No. 44), and the Does and Roes appealed to the Seventh Circuit.

The Seventh Circuit initially ordered a limited remand to the district court for the purpose of entering more extensive findings regarding the disputed documents. *United States v. BDO Seidman LLP*, 2002 U.S. App. LEXIS 28092, Nos. 02-3914, 02-3915, 2002 WL 32080709 at *1 (7th Cir. Dec. 18, 2002). The Seventh Circuit's limited remand instructed the district court to enter findings by January 21, 2003 based on an *in camera* review of the documents over which the Does and Roes had asserted § 7525 privilege and enter findings that consider the "totality of the circumstances." *Id.* (citing *In re Grand Jury Proceedings*, 220 F.3d 568, 572 (7th Cir. 2000). The district court's evaluation on remand of the totality of the circumstances was ordered to include, but not be limited to, the following: "(1) the purpose and history of BDO's representation of the [Does and Roes] with respect to the tax shelter transaction at issue; (2) whether, in light of the purpose and history of BDO's representation as well as the description of the transactions in the IRS summonses, revealing the [Does and Roes']

identities to the IRS necessarily would reveal the [Does and Roes'] motive for seeking tax advice or the substance of that advice; (3) whether the IRS could determine that the [Does and Roes'] had participated in the transactions without obtaining their names from BDO; and (4) whether any of the documents at issue were generated for the purpose of preparing tax returns. 2002 U.S. App. LEXIS 28092, Nos. 02-3914, 02-3915, 2002 WL 32080709 at *1.

Through the district court's internal operating procedures, this case was reassigned to this court on February 3, 2003. (Dkt. Nos. 63, 64, 72). This court issued a memorandum opinion and findings on February 4, 2003 making the further findings as instructed by the Seventh Circuit's limited remand of December 18, 2002 for Doe 1 through Doe 56 and Roe 1 through Roe 42. *United States v. BDO Seidman, LLP*, 2003 U.S. Dist. LEXIS 1634, No. 02 C 4822, 2003 WL 932365 (N.D. Ill. Feb. 5, 2003). The memorandum opinion discussed the law surrounding I.R.C. § 7525 and how the tax practitioner privilege may apply to a potential disclosure of an individual's identity. 2003 U.S. Dist. LEXIS 1634 at *1. Among the findings made by this court in its memorandum opinion of February 4, 2003, this court held: (1) the identity-privilege did exist under § 7525; (2) the tax practitioner privilege under § 7525 did not include communication regarding tax return preparation; (3) the court had to perform a document-by-document review to determine whether the communication was for the purpose of preparing the client's tax return (a communication that is not within the § 7525 privilege); (4) the court had to determine on a document-by-document basis whether the Does and Roes had waived the § 7525 privilege; (5)

the court could not and need not determine whether the crime-fraud exception applied based on the record that was present before it. *Id.*

This court's February 4, 2003 memorandum opinion also provided two general observations about a number of the documents examined by the court during the *in camera* review. First, this court noted that many of the Does and Rocs had documents entitled "Confidentiality Agreement" and contained language that "BDO shall provide, and Recipient shall receive, Confidential information ... for the purpose of providing the Recipient the required information to prepare ... income tax returns." 2003 U.S. Dist. LEXIS 1634 at *3. This court consequently observed that these communications would not be covered under the § 7525 privilege. *Id.*

Second, this court noted that many of the reviewed documents were entitled "Consulting Agreement" and those documents contained the language that "BDO's Services hereunder do not include ... any legal and/or tax opinions regarding any strategies that may be implemented, and has advised [the BDO client] to retain a law firm for legal and/or tax opinions on any strategies or transactions entered into." *Id.* This court held that the "No Warranty" language contained in the consulting agreement documents defined the relationship between BDO and the client in a manner different than the relationship in a traditional attorney-client relationship and consequently would not be covered under the § 7525 tax practitioner privilege. 2003 U.S. Dist. LEXIS 1634 at *4.

The Seventh Circuit reviewed this court's February 4, 2003 findings in its July 23, 2003 decision. *United*

States v. BDO Seidman, LLP, 337 F.3d 802 (7th Cir. 2003). The Seventh Circuit summarized this court's February 4, 2003 stating

> The district court found that 133 of the documents it had reviewed established that BDO's communications with the 55 Does had not been for the purpose of providing tax advice, and were therefore not privileged. Furthermore, the court concluded, 28 of the documents were generated for the purpose of preparing tax returns, another unprivileged category of communication. Finally, with respect to 30 unidentified clients who sought intervention, the court was unable to make findings because no confidentiality agreement, consulting agreements or engagement letters had been produced on their behalf.

Id. at 808.

The Seventh Circuit went on to review the regulatory context surrounding the IRS' enforcement efforts against tax shelters, the IRS' ability to issue summonses and the tax practitioner privilege under I.R.C. § 7525. *Id.* at 808-12. The Seventh Circuit concluded that the Does and Roes could not establish a colorable claim of privilege under I.R.C. § 7525 that would stop the disclosure of their identities. *Id.* at 812. The Does and Roes had not, according to the Seventh Circuit, established that a confidential communication would be disclosed if their identities were revealed. *Id.* Furthermore, due to the requirement that anyone who organizes or sells an interest in a tax shelter is required to maintain a list of the identity of the people to

which the interest was sold, I.R.C. § 6112, the Does and Roes could not have an expectation of confidentiality in their identity, a required element for any privilege claim. *Id.* Thus, the Seventh Circuit affirmed the district court's denial of the Does and Roes motion to intervene issued by Judge Shader on November 1, 2002. The Supreme Court then denied the Does and Roes' petition for a Writ of Certiorari on February 23, 2004. *Roes v. United States*, 540 U.S. 1178, 158 L. Ed. 2d 78, 124 S. Ct. 1410 (2004). With the July 23, 2003 decision from the Seventh Circuit and denial of the petition for Writ of Certiorari, the litigation had concluded on the question of the disclosure of the identity of BDO's clients with the answer that the disclosure of the identity of the Does and Roes was not protected by the tax practitioner privilege under I.R.C. § 7525.

BDO then asserted privilege claims with regard to 110 documents under attorney-client privilege and/or the work product doctrine. BDO did not, however, assert the tax practitioner privilege. This court held on June 29, 2004, after performing an *in camera* review of each of the disputed documents, that 104 of the 110 documents were protected by either the attorney-client and/or work product privilege. *United States v. BDO Seidman, LLP*, 2004 U.S. Dist. LEXIS 12145, No. 02 C 4822, 2004 WL 1470034, at *5 (N.D. Ill. June 29, 2004).

In reviewing the 110 documents, *in camera* in June 2004, this court considered three arguments made by the IRS, two of which are pertinent to the present discussion. First, the IRS argued that the communications between the law firms and BDO were not for the

purpose of legal advice because the law firms were "co-promoters" or marketing partners with BDO. *Id.* at * 1. Second, the IRS asserted that privilege was not applicable because the crime-fraud exception applied. *Id.* The court considered both of these arguments in June 2004 but found that there was not sufficient evidence to find that the law firms were co-promoters not providing legal advice, or that BDO and the law firms were engaging in a crime or fraud so that BDO should be deprived of the protections of the asserted privileges. 2004 U.S. Dist. LEXIS 12145 at *2.

This court then allowed the BDO clients, who had previously been identified, ("Intervenors"), to intervene on July 15, 2004 (Dkt. No. 131) so they could assert objections to BDO's disclosure of documents to the IRS in response to the IRS' motion to compel production of documents of March 31, 2004 (Dkt. No 101).[4] This

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[4] In the United States' Concurrence in the Intervenors' Motion to Intervene and Challenge to Claims of Privilege, (Dkt. No. 129), the government stated that BDO produced to the IRS on June 30, 2004 the remaining BDO client documents where the Intervenors had not asserted a claim of privilege. Although the government did not provide a number of the total documents provided, the court estimates the total number of documents provided to the IRS, and to which the Intervenors did not assert a claim of privilege, to be well in excess of 1000 documents.

The court reaches the figure of "in excess of 1000 documents" based on the fact that the 267 documents provided by the Intervenors for this court's *in camera* review were submitted in a total of seven boxes. This results in a calculation of approximately 38 documents per box submitted to this court. The court then

memorandum opinion and order addresses the privilege claims made by the Intervenors.

ANALYSIS

The dispute before this court is whether the Intervenors' assertion of privilege can prevent the production of the withheld documents submitted for *in camera* review to the IRS. The parties have presented a variety of arguments. The Intervenors claim that the documents are protected from disclosure under the tax practitioner privilege, attorney-client privilege and/or the work product doctrine. The IRS asserts that there is no privilege available for these documents because the documents were not produced for the purpose of obtaining or providing tax advice but instead were part

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multiplied the 38 documents per box by the 28 box figure provided in the government's filing resulting in a number of 1064. The court recognizes that the 1064 figure is calculated based on an assumption that the document and box type provided for this court's *in camera* review are the same type as the document and boxes provided to the government. The court decided to use the phrase "in excess of 1000 documents" in recognition of its assumptions and estimations.

It should also be noted that the figure of "in excess of 1000 documents" only considers documents involving the Intervenors and does not include BDO's internal documents that BDO has previously provided to the IRS. Although the court does not know the total number of documents provided by BDO and the Intervenors to the IRS during the IRS' multi-year investigation, the court believes the total document figure to be significantly larger than 1000.

of a pre-packaged product of abusive tax shelters that BDO had developed, marketed and implemented for the unlawful purpose of assisting the Intervenors evade the payment of federal income taxes. The court will briefly discuss the law of the attorney-client, tax practitioner and work product privileges and then turn to the parties' arguments.

1. Attorney-Client, Tax Practitioner and Work Product Privileges

The Seventh Circuit follows the classic definition of attorney-client privilege first articulated by Dean Wigmore:

> (1) Where legal advice of any kind is sought, (2) from a professional legal advisor in his capacity as such, (3) the communication related to that purpose, (4) made in confidence, (5) by the client, (6) are at his instance permanently protected, (7) from disclosure by himself or by the legal adviser, (8) except the protection be waived.

United States v. BDO Seidman, LLP, 2004 U.S. Dist. LEXIS 12145, No. 02 C 4822, 2004 WL 1470034, at *1 (N.D. Ill. June 29, 2004) (citing *United States v. Evans*, 113 F.3d 1457, 1461 (7th Cir. 1997)). "The party seeking to invoke the privilege bears the burden of proving all of its essential elements." *Rohr-Gurnee Motors, Inc. v. Patterson*, 2004 U.S. Dist. LEXIS 2068, No. 03 C 2493,2004 WL 422525, at *3 (N.D. Ill. Feb. 9, 2004). "The purpose of the privilege is to encourage full disclosure and to facilitate open communication between attorney and their clients." *United States v.*

BDO Seidman, LLP, 337 F.3d 802, 810 (7th Cir. 2003) (citing *Swidler & Berlin v. United States*, 524 U.S. 399, 403, 141 L. Ed. 2d 379, 118 S. Ct. 2081 (1998)). "However, because 'the privilege has the effect of withholding relevant information,' courts construe the privilege to apply only where necessary to achieve its purpose." *Id.* at 810-11 (quoting *Fisher v. United States*, 425 U.S. 391, 403, 48 L. Ed. 2d 39, 96 S. Ct. 1569 (1976)). The Seventh Circuit has described the attorney-client privilege in the following manner:

> The attorney-client privilege is intended to encourage people who find themselves involved in actual or potential legal disputes to be candid with any lawyer they retain to advise them. *Upjohn Co. v. United States*, 449 U.S. 383, 389, 66 L. Ed. 2d 584, 101 S. Ct. 677 (1981). The hope is that this will assist the lawyer in giving the client good advice (which may head off litigation, bring the client's conduct into conformity with law, or dispel legal concerns that are causing the client unnecessary anxiety or inhibiting him from engaging in lawful, socially productive activity). ... Communication from a client that neither reflects the lawyer's thinking nor are made for the purpose of eliciting the lawyer's professional advice or other legal assistance are not protected.

United States v. Frederick, 182 F.3d 496, 500 (7th Cir. 1999). In addition to protecting communications from a client to an attorney, communications from an attorney to a client are privileged if the communication constitute legal advice or would directly or indirectly reveal the substance of a client confidence. *United*

States v. BDO Seidman, LLP, 2004 U.S. Dist. LEXIS 12145, No. 02 C 4822, 2004 WL 1470034, at *2 (N.D. Ill. June 29,2004) (citing *United States v. Defazio*, 899 F.2d 626, 635 (7th Cir. 1990)). A communication that is covered under the privilege can be conveyed orally or through a variety of written formats including memoranda, letters, emails, facsimiles, summaries and handwritten notes. *United States v. BDO Seidman, LLP*, 2004 U.S. Dist. LEXIS 12145, No. 02 C 4822, 2004 WL 1470034, at *2-3 (N.D. Ill. June 29, 2004).

The tax practitioner privilege is a statutory creation of Congress. *See, e.g., Frederick*, 182 F.3d at 500 ("There is no common law accountant's or tax preparer's privilege.") (quoting *Couch v. United States*, 409 U.S. 322, 335, 34 L. Ed. 2d 548, 93 S. Ct. 611 (1973); *United States v. Arthur Young & Co.*, 465 U.S. 805, 817-19, 79 L. Ed. 2d 826, 104 S. Ct. 1495 (1984)). The tax practitioner privilege, codified at I.R.C. § 7525(a)(1), states that "with respect to tax advice, the same common law protections of confidentiality which apply to a communication between a taxpayer and an attorney shall also apply to a communication between a taxpayer and a federally authorized tax practitioner to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney." I.R.C. § 7525(a)(1).

The tax practitioner privilege is interpreted based on the common law rules of the attorney-client privilege. *United States v. BDO Seidman, LLP*, 337 F.3d 802. 810-12 (7th Cir. 2003). The communications are made, however, for the purpose of tax advice instead of legal advice, *Id.* at 811, and the client's communication is with a federal authorized tax practitioner instead of

an attorney. The statute defines a "federally authorized tax practitioner" as "any individual who is authorized to practice before the IRS" and "tax advice" means "advice given by an individual with respect to a matter which is within the scope of the individual's authority to practice" as described under the tax practitioners privilege. I.R.C. §§ 7525 (a)(3)(A), (B).

The tax practitioner privilege, like the attorney-client privilege, is not an absolute bar to disclosures, but instead contains limitations on the scope of the privilege. The tax practitioner privilege only applies to communications made on or after statute's enactment date of July 22, 1998. *Frederick*, 182 F.3d at 502. The language of the statute expressly limits the privilege to "noncriminal tax matters before the IRS," I.R.C. § 7525(a)(2)(A), and "noncriminal tax proceedings in Federal court brought by or against the United States." I.R.C. § 7525(a)(2)(B). The statute also prohibits the application of the tax practitioner privilege to "any written communication between a federally authorized tax practitioner" and client "in connection with the promotion of the direct or indirect participation of the person in any tax shelter (as defined in [I.R.C.] § 6662(d)(2)(C)(ii)). I.R.C. § 7525(b). A tax shelter is defined as "a partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, if a significant purpose of such partnership, entity, plan or arrangement is the avoidance or evasion of Federal income tax." I.R.C. § 6662(d)(2)(C)(ii).

The limitations on the attorney-client privilege, such as the crime-fraud exception, are incorporated into the tax practitioner privilege through the applica-

tion of the common law interpretations of the attorney-client privilege when interpreting the tax practitioner privilege. *United States v. BDO Seidman, LLP*, 337 F.3d 802, 810 (7th Cir. 2003). Furthermore, the phrase "tax advice," the communication covered under the tax practitioner privilege, "does not include communication regarding tax return preparation; it simply encompasses communication such as tax planning advice." *United States v. BDO Seidman, LLP*, 2003 U.S. Dist. LEXIS 1634, No. 02 C 4822, 2003 WL 932365, at *2 (N.D. Ill. Feb. 5, 2003) (citing *In re Grand Jury Proceedings*, 220 F.3d 568, 571 (7th Cir. 2000); *United States v. Frederick*, 182 F.3d 496 (7th Cir. 1999); *United States v. KPMG LLP*, 237 F. Supp. 2d 35, 2002 WL 31894130, at *4 (D.D.C. 2002)).

The work product doctrine, announced in *Hickman v. Taylor*, 329 U.S. 495, 91 L. Ed. 451, 67 S. Ct. 385 (1947), and codified in Rule 26(b)(3) of the Federal Rules of Civil Procedure, protects against the discovery of documents and other tangible things that would be otherwise be discoverable under the Federal Rules. Fed. R. Civ. P. 26(b)(3). The work product doctrine is a qualified doctrine that is distinct and broader than the attorney-client privilege. *Caremark v. Affiliated Computer Servs., Inc.* 195 F.R.D. 610, 613 (N.D. Ill. 2000) (citing *United States v. Nobles*, 422 U.S. 225, 238 n.11, 45 L. Ed. 2d 141, 95 S. Ct. 2160 (1975)). "If a party demonstrates that materials in its possession that would otherwise be discoverable were prepared in anticipation of litigation, the materials are considered work product and become subject to a qualified privilege from discovery. The qualified privilege may only be overcome if the party seeking production demonstrates both a substantial need for the materials and

that it would suffer undue hardship in prosecuting the requested information some other way." *Logan v. Commerical Union Ins. Co.*, 96 F.3d 971, 976 (7th Cir. 1996). Furthermore, the privilege applies when "the document can fairly be said to have been prepared or obtained *because* of the prospect of litigation." *Id.* at 976-77 (emphasis in original) (citations omitted).

Upon this court's review of the documents submitted for *in camera* review and the Intervenors explanations as provided in their memoranda and privilege log, this court finds that the documents submitted by the Intervenors appear to fall within either the attorney-client, tax practitioner and/or work product privileges. The court shall therefore turn to the arguments made by the government in which it attempts to argue that attorney-client, tax practitioner and work product privileges should not apply.

2. The Government's Arguments

The government has provided several arguments against the recognition of privilege for the Intervenors. The government's arguments raise the following issues for the court to address: (1) Are the Intervenors prohibited from making a claim of privilege under the crime-fraud exception to the attorney-client, tax practitioner and/or work product privilege? (2) Does the "No Warranty" language contained in the consulting agreement between BDO and various Intervenors demonstrate that BDO was not providing the type of advice that would implicate either the protections of the attorney-client or tax practitioner privilege? and (3) What is the authoritative weight of the decision of the United States District Court for the Southern

District of New York in *Denney v. Jenkens & Gilchrist*, 340 F. Supp. 2d 338 (S.D.N.Y. 2004), and specifically, must the court follow that decision as it applies to Intervenors Hawkins and Khan under the doctrine of offensive collateral estoppel?

A. Crime-Fraud Exception

The IRS argues that the Intervenors cannot assert attorney-client privilege, tax practitioner privilege or the work product doctrine because the Intervenors were involved in fraudulent transactions by purchasing illegal tax shelters from BDO and BDO and the Intervenors attempt to inappropriately conceal these transactions from the IRS. The IRS supports its argument by pointing to the decision in *Denny v. Jenkens & Gilchrist*, where Judge Scheindlin determined that BDO had entered into a mutually fraudulent consulting agreement. 340 F. Supp. 2d 338, 346-47 (S.D.N.Y. 2004). The IRS also provides the declaration of IRS Revenue Agent Sandra Alvelo and a number of documents obtained through the IRS summonses from BDO.

The IRS presents a picture of BDO, along with firms of Jenkens & Gilchrist, ("J&G"). Diversified Group, Inc., Helios, ICA-Bricolage and Gramercy, and Brown and Wood, ("B&W")[5] as a producers, marketers and implementers of allegedly illegal tax shelters. The IRS' argument is that BDO produces financial transactions or "tax products" that it markets to clients who

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[5] The law firm of Brown & Wood is now known as Sidley Austin Brown & Wood LLP.

are looking to evade their tax liabilities. By its continual reference to these transactions as "abusive," "prepackaged," and "cookie cutter," the IRS is attempting to brand BDO as the proprietor of "off-shelf" prepackaged retail tax shelters sold to the Intervenors for the singular unlawful purpose of evading tax liability.

In essence, the IRS alleges that everything done by BDO, the third party law firms and the Intervenors in these transactions, under the guise of a legitimate business purpose, is nothing more than an attempt to cover-up the unlawful purpose of the tax shelters. The IRS asserts this type of cover-up is necessary because the allegedly illegal tax shelters produced and marketed by BDO are the same or substantially the same as ones that have been previously determined to have been abusive in published IRS notices. The IRS concludes that since BDO and the Intervenors must be aware of the illegal nature of BDO's tax products, BDO and the Intervenors must be engaged in a practice of concealing its illegal activities and this deprives them of the benefits of attorney-client, tax practitioner and work-product privileges under the crime-fraud exception.

"Under the crime-fraud exception, communications that would otherwise be protected by the attorney-client privilege, [as well as tax practitioner privilege], lose their protected status if they were 'made for the purpose of getting advice for the commission of a fraud or crime.'" *United States v. Segal*, 2004 U.S. Dist. LEXIS 6616, No. 02 CR 112, 2004 WL 830428, at *1 (N.D. Ill. Apr. 16 2004) (quoting *United States v. Zolin*, 491 U.S. 554, 563, 105 L. Ed. 2d 469, 109 S. Ct. 2619 (1989)). "The crime-fraud exception applies where the

party attempting to circumvent the privilege, [in the present case the IRS,] can meet the following test: (1) a *prima facie* showing of [a crime or] fraud, and (2) the communications in question are in furtherance of the misconduct." *Vardon Golf Co., Inc. v. Karsten Mfg. Corp.*, 213 F.R.D. 528, 535 (N.D. Ill. 2003) (citing *Pandick, Inc. v. Rooney*, 1988 U.S. Dist. LEXIS 5436, No. 85 C 6779, 1988 WL 61180, at *2 (N.D. Ill. June 2, 1988)).

As the Seventh Circuit explained in *United States v. Davis*,

> To drive away the privilege ... there must be something to give colour to the charge; there must be *prima facie* evidence that it has some foundation in fact. When the evidence is supplied, the seal of secrecy is broken. [The Seventh Circuit has] also noted that *prima facie* evidence did not mean enough to support a verdict in favor of the person making the claim. Instead [the Seventh Circuit has] held that a party has established a *prima facie* case whenever it presents evidence sufficient to require the adverse party, the one with superior access to the evidence and in the best position to explain things, to come forward with that explanation. [The Seventh Circuit has] also stated that if the district court finds such an explanation satisfactory the privilege remains and that the district court's decisions regarding these

> matters may be disturbed only for an abuse of discretion.

1 F.3d 606, 609 (7th Cir. 1993) (internal quotations and citations omitted).

The court, after reviewing documents presented in IRS Agent Alvelo's declarations and the arguments presented in the IRS' briefs, finds that the IRS has not presented a *prima facie* case that BDO and the Intervenors are engaging in fraudulent or criminal activity in the general pattern alleged by the IRS. The court is not prepared to accept the far reaching and blanket assertions made by the IRS at this time. *Accord United States v. Arthur Andersen, L.L.P*, 273 F. Supp. 2d 955, 960-61 (N.D. Ill. 2003) (noting that the IRS' argument for the crime-fraud exception in that case was "at the best bootstrapping") *amended on other grounds* 2003 U.S. Dist. LEXIS 14228, No. 02 C 6790, 2003 WL 21956404 (N.D. Ill. Aug. 15, 2003).

As this court concluded in its review of the IRS' crime-fraud exception argument in its June 29, 2004 opinion, "the government has based its arguments for the application of the crime-fraud exception on what to this point is speculation and innuendo." 2004 U.S. Dist. LEXIS 12145, No. 02 C 4822, 2004 WL 1470034, at *4. Although the government provides various documents, it continues to provide significant speculation as to BDO and the Intervenors' motives and activities.

The fact that the IRS characterizes a business or individual's transactions as abusive and unlawful cookie cutter tax shelters does not mean that this

characterization is a proper conclusion as a matter of law. Instead, "the issue of whether [BDO] organized or sold tax shelters" in violation of the law is a "complicated question." *United States v. Sidley Austin Brown & Wood, LLP*, 2004 U.S. Dist. LEXIS 7355, No. 03 C 9355, 2004 WL 905930, at *6 (N.D. Ill. Apr. 28, 2004). As this court noted when the IRS argued for the crime-fraud exception in the June 29, 2004 opinion, the tax code and underlying regulations is full of complexities and uncertainties. 2004 U.S. Dist. LEXIS 12145, No. 02 C 4822, 2004 WL 1470034, at *4. The question of whether the Intervenors and BDO engaged in unlawful activity, or alternative properly complied with the tax code, is one of the ultimate questions for this litigation. A determination by this court that BDO and the Intervenors engaged in fraudulent and criminal activity, based on the lack of evidence presented by the IRS at this time, would be premature and would place the proverbial "Cart before the Horse."[6]

Although this court is unwilling to hold as a blanket matter that the Intervenors are barred from bringing privilege claims under the crime-fraud exception, the court will consider, as it did in its June 29, 2004 opinion, whether the crime-fraud exception should be applied when reviewing *in camera* the individual documents. This court cannot deprive the Intervenors, at this time, of the right to assert a claim

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[6] On this basis and for the same reasons, the court cannot say as a matter of law, at this stage in the litigation, that BDO and the Intervenors are engaging in tax shelters, as defined under I.R.C. § 6662(d)(2)(C)(ii), that would require the application of the exception to the tax practitioner privilege under I.R.C. § 7525(b).

of privilege, but this court will consider whether the crime-fraud exception should be applied on a document-by-document basis for each document pertaining to the each Intervenor's activities reviewed by the court *in camera*.

The IRS suggests that the court should consider the following to be indications of fraud that could be sufficient to support a *prima facie* showing of fraud: (1) the marketing of pre-packaged transactions by BDO;[7] (2) the communication by the Intervenors to BDO with the purpose of engaging in a pre-arranged transaction developed by BDO or third party with the sole purpose of reducing taxable income; (3) BDO and/or the Intervenors attempting to conceal the true nature of the transaction; and (4) knowledge by BDO, or a situation where BDO should have known, that the Intervenors lacked a legitimate business purpose for entering into the transaction.

The court will consider the IRS' suggested indicators of potential fraud during the court's *in camera* review of the documents. These factors, although they will be considered by the court, are not dispositive on

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[7] The IRS continues its argument that BDO was providing prepackaged transactions in the IRS' sur-reply which points to the fact that opinion letters provided to different Intervenors were identical. The use of an identical document, however, does not mean that BDO was not providing individualized advice. The use form or boiler-plate document, which are often used as the basis in providing professional services, is not by itself evidence of a fraud but as the court discusses later a factor that the court shall consider within the totality of the circumstances.

the question of whether a crime-fraud exception applies because the court must make its own independent determination as to whether there is sufficient evidence to show that "(1) a *prima facie* showing of [a crime or] fraud, and (2) the communications in question are in furtherance of the misconduct." *Vardon Golf Co., Inc. v. Karsten Mfg. Corp.*, 213 F.R.D. 528, 535 (N.D. Ill. 2003).

Furthermore, this court will also considered the current regulatory environment in which the IRS, accounting and consulting firms and taxpayers currently interact when reviewing the documents to determine whether a *prima facie* case for the crime-fraud exception is presented in each individual document. A number of cases have been recently brought in the federal courts attempting to address whether transactions produced and marketed by accounting, consulting and law firms were abusive tax shelters in violations of the tax code. Some of these cases address questions of privilege and the crime-fraud exception while others, although involving the factual question of tax shelters, involved legal issues unrelated to the question of privilege. The court does not find any of one case to be controlling on the question of whether the Intervenors are barred from asserting privilege under the crime-fraud exception. However, the court shall briefly discuss three of these cases that provide a background from which the court can draw to identify potential indicators of fraud that could lead to a finding of *prima facie* showing of a crime-fraud and communication in furtherance of the crime-fraud.

i. Denney v. Jenkens & Gilchrist and Miron v. BDO Seidman, LLP

The IRS has invited the court's attention to *Denney v. Jenkens & Gilchrist*, 340 F. Supp. 2d 338 (S.D.N.Y. 2004), in support of its claim of a blanket application of the crime-fraud exception to all of the Intervenors' privilege claims. This court has previously considered and rejected the application of *Denney* during the IRS's argument for a blanket application of the crime-fraud exception in the June 29, 2004 opinion. 2004 U.S. Dist. LEXIS 12145, No. 02 C 4822, 2004 WL 1470034, at *4. The court again considered the *Denney* case in this opinion when in it ultimately concluded that the IRS has not provided evidence sufficient to require the court to impose a blanket application of the crime-fraud exception. Although the *Denney* case does not give sufficient evidence to automatically deprive the Intervenors of privilege under the crime-fraud exception, it does provide guidance for indicators of fraudulent activity that the court may identify during its document-by-document *in camera* review.

The *Denney* case involves a civil RICO class action lawsuit brought by former clients of various professional firms including BDO. 340 F. Supp. 2d at 340-41. The question before the *Denney* court was whether the court should grant the defendants' motion to compel arbitration. *Id.* As this court noted in June 29, 2004 opinion, the factual background presented in the *Denney* case was taken from the plaintiffs' complaint. 2004 U.S. Dist. LEXIS 12145, No. 02 C 4822, 2004 WL 1470034, at *2 ("The plaintiffs in *Denney* allege, *inter alia*, that the law firm and accounting firm, including BDO, defendants were co-promoters of tax shelters. As

BDO correctly points out, allegations in a complaint are merely that - allegations."). The *Denney* court did, however, conclude that since BDO had entered into a mutually fraudulent consulting agreement, BDO could not invoke the arbitration clause consulting agreements and therefore the *Denney* court denied the defendants' motion to compel arbitration. 340 F. Supp. 2d at 345-47.

The *Denney* court explained its finding in the following manner:

> Based on the representations by counsel for plaintiffs and BDO, as well as the extraordinary vague language contained in the consulting agreements, I conclude that BDO and plaintiffs engaged in mutual fraud when they executed the consulting agreements. It appears that neither plaintiffs nor BDO wanted any third party to know the nature of the contracts into which they entered, or that BDO had contracted with plaintiffs to provide tax shelter advice. As a result, they entered into agreements that described consulting work that was never performed and that was different from the consulting services that were actually provided. This conclusion is supported by the statements of counsel during the April 14, 2004 telephone conference, as well as the fact that while BDO apparently never provided any services to plaintiffs other than tax shelter advice, plain-

> tiffs paid BDO in accordance with the consulting agreements.

Id. at 346-47. The *Denney* court in a footnote characterized the arrangement as one where "both sides were in on the wink and the nod." *Id.* at 346 n.9.

It is important to note that just because one of BDO's consulting agreements has been found to have fraudulent does not mean that all consulting agreements entered into by BDO were fraudulent. This principle was illustrated in the decision of the Eastern District of Pennsylvania in *Miron v. BDO Seidman, LLP*, 342 F. Supp. 2d 324, 329-30 (E.D. Pa. 2004). That case also considered the question of whether the court should enforce an arbitration clause contained in a consulting agreement between BDO and one of its former clients. The *Miron* court considered the *Denney* court's conclusion and instead arrived at the opposite result of finding that the arbitration clause was valid and enforceable holding that "the record in this case does not suggest a mutual intent into a fraudulent agreement." *Id.* at 330.

Upon a review of the *Denney* and *Miron* decisions, the court concludes that potential indicators of fraud include: (1) a vaguely worded consulting agreement between BDO and the Intervenor, and (2) BDO's failure to provide services required under the consulting agreement while still receiving payment from the Intervenor. Furthermore, the *Denney* and *Miron* cases involved an alleged tax shelter called the "Currency Options Bring Reward Alternative." ("COBRA") As this court previously noted, the *Denney* and *Miron* cases did not consider the question of whether COBRA was

a tax shelter. However, in light of fact that BDO's former clients are alleging in two separate cases that COBRA is a tax shelter, this court will consider references in the document to COBRA transaction as an indicator of potential fraud.

The court's consideration of potential fraud that it may identify in its review of the documents is tempered by an understanding that the alignment of the parties in *Denney* and *Miron* are different from the parties in the present case. BDO's former clients and BDO were opposing parties in *Denney* and *Miron* while in the present case BDO and its clients, the Intervenors, are aligned against the IRS. In *Denney* and *Miron*, it was the former BDO clients who were alleging that BDO engaged in fraudulent activity while in the present case it is the government, and not BDO's clients, who is alleging wrong doing. Furthermore, Judge Scheindlin obtained what she construed to be an admission of the fraudulent activity from counsel from both sides in the *Denney* case, 340 F. Supp. 2d at 346 n.9, while BDO and the Intervenors both deny fraudulent activity in the present case.

ii. United States v. KPMG

A second case that the court will draw upon in determining whether evidence exists of potential fraudulent activity is *United States v. KPMG*, 316 F. Supp. 2d 30, 40 (D.D.C. 2004). In *KPMG*, the District Court for the District of Columbia concluded that opinion letters produced by the law firm of Brown & Wood were "boiler-plate templates that are almost, if not completely, identical except for date, investor name, investor advisor and dates and amounts of

investment transactions." *Id.* The court shifted the burden to KPMG to demonstrate that the letters were indeed legal advice instead of "nothing more than an orchestrated extension of KPMG's marketing machine." *Id.*

This court considered the *KPMG* case in its June 29, 2004 opinion. In that opinion, this court held that "evidence of "coordinated partnership between BDO and the [outside law firms] was lacking." 2004 U.S. Dist. LEXIS 12145, No. 02 C 4822, 2004 WL 1470034, at *2. Consequently, this court held that the evidence was not sufficient to label the outside law firms as co-promoters and therefore rejected the government's efforts to remove the protection of the attorney-client relationship. *Id.*

As with the *Denney* case discussed above, the court has examined the *KPMG* case in terms of the potential indicators of fraud that the court should look for when performing an *in camera* inspection of the submitted documents to determine whether the government can meet the *prima facie* test on an individual document-by-document basis. The *KPMG* court focused on the boiler-plate nature of the "opinion letters" provided by outside law firms to KPMG's clients. 316 F. Supp. 2d at 40. The idea of a boiler-plate letter fits within the government's overall allegation that BDO and the associated law firms are not providing individualized advice but instead are providing the product of a tax shelter.

iii. Summary of Potential Indicators of Fraud that the Court Looked for During the In Camera Review of the Submitted Documents

In summary, the court has considered the following to be potential indicators of fraud when it performed the *in camera* review of the submitted documents to determine whether there is sufficient evidence to support a *prima facie* showing of fraud: (1) the marketing of pre-packaged transactions by BDO; (2) the communication by the Intervenors to BDO with the purpose of engaging in a pre-arranged transaction developed by BDO or third party with the sole purpose of reducing taxable income; (3) BDO and/or the Intervenors attempting to conceal the true nature of the transaction; (4) knowledge by BDO, or a situation where BDO should have known, that the Intervenors lacked a legitimate business purpose for entering into the transaction; (5) vaguely worded consulting agreements; (6) failure by BDO to provide services under the consulting agreement yet receipt of payment; (7) mention of the COBRA transaction; and (8) use of boiler-plate documents. The court does not limit itself to the indicators in determining whether a *prima facie* case for the application of the crime-fraud exception. Instead, this court looks to the "totality of the circumstances," *United States v. BDO Seidman LLP*, 2002 U.S. App. LEXIS 28092, No. 02 C 4822, 2002 WL 32080709 (7th Cir. Dec. 18, 2002), surrounding each document in order to determine whether there is "something to give colour to the charge ... so as to require the [Intervenors], the one[s] with superior access to the evidence and in the best position to explain things, to come forward with that explanation. *United States v. Davis*, 1 F.3d 606, 609 (7th Cir. 1993)

(internal quotations and citations omitted). Furthermore, its important note that an indication of potential fraud does not mean that fraud exists sufficient for a *prima facie* finding. These factors are merely guideposts to assist this court in its *in camera* evaluation.

iv. Results of the Court's In Camera Inspection of the Submitted Documents

The court's *in camera* review of the documents submitted by the Intervenors, based on the totality of the circumstances and with consideration of the potential indicators of fraud outlined above, the court identified only one document providing a "foundation of fact," *United States v. Davis, supra*, 1 F.3d at 609, upon which this court can find that a *prima facie* case for the crime-fraud exception had been established. This document is A-40.[8] The court is specifically concerned with what is stated in the first sentence of the second paragraph in the email contained on page 2 of A-40 (Bates Number 11 BDO P00003428), but the Intervenors' explanation should cover the entire document not just one sentence. The burden is now on Intervenor Robert Cuillo, and any other Intervenor that asserts privilege as to this document, to provide an explanation as to why this document should not be

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[8] The privilege log states that Document A-40 is an e-mail sent from BDO employee Michael Kerekes to BDO employees Robert Greisman and Lawrence Cohen and a copy was provided to Paul Shanbrom. The document's Bates Range is 11 BDO P 00003427-00003429. This document is related to Intervenor Robert Cuillo but the privilege log also states that it is listed to multiple clients.

disclosed to the government under the crime-fraud exception.

Of the remaining 266 documents where the court has not found evidence sufficient to hold that a *prima facie* case exists requiring an explanation from an Intervenor, a dozen of the other documents contained one of the eight indicators or some other indicator of potential fraud. Some documents made reference to calculation of commissions based on a percentage of the total transaction, discussed some of the activities as "financial products," use of "boiler-plate opinions," providing "tax solutions" and tracking various "deals."[9]

Despite these indicators, the court is not prepared at this time to conclude as Judge Hogan did in *United States v. KPMG*, that BDO and the associated law firms were not giving advice, but instead were providing documents that were nothing more than "orchestrated extensions" of the accounting and law firms' "marketing machine." 316 F. Supp. 2d 30, 40 (D.D.C. 2004). Nor is the court ready to conclude that under the totality of the circumstances their appears "a wink and a nod," *Denney*, 340 F. Supp. 2d at 346 n.9, between BDO, the law firms and the Intervenors so as to require a *prima facie* finding of crime-fraud for any of other documents. For the remaining 254 documents,

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[9] The twelve documents containing one of these references are A-3, A-32, A-36, N-1, N-6, O-23, P-10, Q-15, Q-17, Q-22, Q-25, R-8, R-18. The court does not find these references because of their context to provide "the foundation in fact" to compel a further requisite explanation by the Intervenors to which the documents pertain.

this court found no indications of anything that might suggest that the crime- fraud exception might apply.

B. "No Warranty" Language

This court previously considered the impact of "No Warranty" language contained in consulting agreements between a number of the Intervenors and BDO in the February 5, 2003 decision. 2003 U.S. Dist. LEXIS 1634, No. 02 C 4822, 2003 WL 932365 (N.D. Ill. Feb. 5, 2003) *aff'd*, 337 F.3d 802 (7th Cir. 2003), *cert. denied sub nom.* 540 U.S. 1178, 158 L. Ed. 2d 78, 124 S. Ct. 1410 (2004). In the February 5, 2003 opinion, this court held that "the 'No Warranty' language makes the relationship defined by the 'Consulting Agreement' to be different than the common law taxpayer-attorney relationship" and therefore the Does and Roes who's "Consulting Agreement" contained the "No Warranty" type language could not assert the § 7525 tax practitioner privilege to protect from the disclosure of their identities." 2003 U.S. Dist.1634 at *3-4.

The IRS' concurrence in the Intervenors' Motion to Intervene and Challenge to Claims of Privilege (Dkt. No. 129), filed July 14, 2004 draws the court back to its ruling on the impact of the "No Warranty" language contained in the "Consulting Agreements" on the Intervenors' current assertion of privilege. The IRS asserts that Intervenor Robert S. Cuillo, (2003 U.S. Dist. LEXIS 1634 at 2-3), Richard Garman, (2003 U.S. Dist. LEXIS 1634 at 6), Jai N. Gupta, (2003 U.S. Dist. LEXIS 1634 at 8), Dwayne Hawkins, (2003 U.S. Dist. LEXIS 1634 at 9), Shahid Khan, (2003 U.S. Dist. LEXIS 1634 at 10-11), Arlene Nussdorf, (2003 U.S.

Dist. LEXIS 1634 at 13-14), Glenn Nussdorf, (*Id.*), Glenn Nussdorf Trust, (*Id.*), Ruth Nussdorf, (*Id.*), Stephen Nussdorf, (*Id.*), and Quality King (*Id.*), entered into consulting agreements with the "No Warranty" language that this court has previously determined to deprive the Intervenors of privilege under § 7525.

The IRS' position is that this court's "No Warranty" holding in the February 5, 2003 opinion fits into the IRS' overall view that BDO and the associated law firms were not providing advice but instead a "cookie cutter" tax shelter. As the IRS argued in its August 27, 2004 brief, "BDO was not providing tax advice [thus the inclusion of the "No Warranty" language] because [BDO] was in the business of marketing pre-packaged tax shelters. No confidential communication from the customer [the Intervenor] was necessary or expected because all the customer had to do was determine the amount of the elimination that he wished to purchase." (Dkt. No. 135 at 9.) Thus, the IRS argues that Intervenors Cuillo, Garman, Gupta, Hawkins, Khan, Arlene Nussdorf, Glenn Nussdorf, Glenn Nussdorf Trust, Ruth Nussdorf, Stephen Nussdorf, and Quality King are prohibited from asserting any type of privilege.

The Intervenors respond that this court's decision on the "No Warranty" language in the February 5, 2003 opinion does not deprive the Intervenors of privilege in the present matter because this court's holding on the "No Warranty" language only applies to the writing of tax opinions. (Dkt. No. 139 at 10). The Intervenors contrast the writing of tax opinions to "pre-transactional tax advice," which the Intervenors

claim to have received and which they claim is covered under the privileges. (*Id.*)

This court did not make a distinction in the February 5, 2003 opinion, as the Intervenors suggest, between "tax opinions" and "pre-transactional tax advice." That issue was not considered by the court because the purpose the February 5, 2003 memorandum opinion and findings was to create the further findings as instructed by the Seventh Circuit in its limited remand. Nos. 02-3914, 02-3915, 2002 U.S. App. LEXIS 28092, 2002 WL 32080709 at *1 (7th Cir. Dec. 18, 2002). This court also notes that the Seventh Circuit did not discuss the validity of the court's determinations of the "No Warranty" language in its July 23, 2003 opinion. 337 F.3d 802 (7th Cir. 2003). Instead, the court arrived at a decision based on other arguments. *Id.* at 810-13. Furthermore, this court's February 5, 2003 opinion only considered the question of whether the Intervenors' privilege claim prevented a disclosure of document that would disclose their identity while in this case the Intervenors are objecting to the disclosure of underlying communications contained within these documents. Thus, it appears to the court that the parties are presenting a new argument, or perhaps the extension of a prior ruling from this court to new factual issues previously not considered by this court, when they argue as to the impact of the "No Warranty" language to the Intervenors' current privilege claims.

When this court performed the tasks it was instructed to perform by the Seventh Circuit during the limited remand in 2003, it reviewed confidentiality agreements, consulting agreements and engagement

letters. Now this court has been presented with different types of documents such as memorandums, letters and emails. Upon examining these documents, it appears that the Intervenors have engaged in a business relationship with BDO to receive tax advice. There are no tax returns in the *in camera* documents nor are there any documents that appear to be used in the preparation of tax returns. Thus, unlike this court's decision on February 3, 2003, where this court held that the "No Warranty" language established a relationship different than the common law taxpayer-attorney relationship, and therefore denied the application of privilege, *United States v. BDO Seidman LLP*, 2003 U.S. Dist. LEXIS 1634, No 02 C 4822, 2003 WL 932365, at *3-4 (N.D. Ill. Feb. 5, 2003), the communications occurring between the Intevenors, BDO and their lawyers appears to this court, at this point in the litigation, to fall squarely within the type of tax and legal advice protected under the tax practitioner and attorney-client privileges.

C. Penny Case Impact

IRS also argues that this court is bound by Judge Scheindlin's decision in the *Denny* case, 340 F. Supp. 2d 338 (S.D.N.Y. 2004), as it applies to Intervenors Hawkins and Khan. According to the government, the *Denny* case involved virtually identical facts to this case and since Hawkins and Khan were involved in the *Denny* case, the doctrine of offensive collateral estoppel requires the application of Judge Scheindlin's finding of fraudulent activity in that case to the present case.

As discussed above, the *Denny* case deals with different factual issues from the present case. That

case involved a civil suit between BDO and its former clients while this case involves the IRS' investigation of BDO and its clients. Furthermore, the fact that BDO has entered into a fraudulent activity or even an Intervenor has admitted into entering into a fraudulent activity in one case does not mean that all of their activities are now fraudulent in all cases. From this court's reading of the *Denny* decision and this court's review of the documents provided for *in camera* inspection, the activities evaluated by Judge Scheindlin in the *Denny* decision are different from the activities this court has been required to scrutinize in this case.

CONCLUSION

For the reasons set forth above, the documents submitted to the court for *in camera* review, with the exception of document A-40, are held to be privileged and need not be disclosed to the government. This order covers the documents submitted on the Intervenors Amended Privilege Log of September 10, 2004 (Dkt. No. 142), and the two supplemental documents provided by Intervenors R.K. Lowry, Jr. and John P. Moffitt on August 23, 2004. (Dkt. No. 137).

The court holds, based on its *in camera* review, that a *prima facie* case for the application of the crime-fraud exception has been established for document A-40. The burden is now upon Intervenor Robert Cuillo, and any other Intervenors who believes that they have a privilege in this document, to come forward with an explanation as to why the document should not be disclosed to the government under the crime-fraud exception. This explanation by any Intervenors must

be filed with the court by April 14, 2005. The government response is due April 28, 2005 and the Intervenors' reply is due May 10, 2005.

ENTER:

JAMES F. HOLDERMAN

United States District Judge

DATE: March 30, 2005

APPENDIX E

INTERNAL REVENUE CODE
26 U.S.C. § 7525 (2001)

Effective: July 22, 1998 to October 21, 2004

§7525. CONFIDENTIALITY PRIVILEGES RELATING TO TAXPAYER COMMUNICATIONS

(a) UNIFORM APPLICATION TO TAXPAYER COMMUNICATIONS WITH FEDERALLY AUTHORIZED PRACTITIONERS. –

(1) GENERAL RULE. – With respect to tax advice, the same common law protections of confidentiality which apply to a communication between a taxpayer and an attorney shall also apply to a communication between a taxpayer and any federally authorized tax practitioner to the extent the communication would be considered a privileged communication it if were between a taxpayer and an attorney.

* * *

(b) SECTION NOT TO APPLY TO COMMUNICATIONS REGARDING CORPORATE TAX SHELTERS. – The privilege under subsection (a) shall not apply to any written communication between a federally authorized tax practi-

tioner and a director, shareholder, officer, or employee, agent, or representative of a corporation in connection with the promotion of the direct or indirect participation of such corporation in any tax shelter (as defined in Section 6662(d)(2)(C)(iii)).

APPENDIX F

EXHIBIT A-40

PRIVILEGED & CONFIDENTIAL
FOR *IN CAMERA* REVIEW ONLY

[p.1]

Distressed Debt 2001 Transactions

11 BDO P00003427

[p.2]

Robert Greisman - Re: Missing Documents Page 1

From: Michael Kerekes
To: BGreisman@bdo.com.LCohen.New York. NF
Date: 12/19/01 10:43AM
Subject: Re: Missing documents

The sales or exchanges will take place next week. I expect no cash proceeds in the case of distressed debt deals. Cash proceeds on the Gramercy II deals will probably sit around for a few days, then be reinvested in assets consistent with the business purpose of their investors.

I expect that Larry and I will provide Jay a list of losses to be triggered so we can make sure each client gets what he wants. Parts of that list will have to wait

until we have final information. The Cottage Savings swaps should take place pursuant to documents, but I have not seen the documents. (Larry, do you have a copy of last year's form? If not, we'll get it from Jay.) From a technical perspective, the swaps will fit within the facts of Cottage Savings, except that in this case, while the parties will be unrelated, they may be commonly controlled or advised (by Gramercy). (The Cottage Savings court noted no overlap among the boards of directors of the two entities involved, although I don't why that would be a critical factor as long as the parties' transaction reflected arm's-length terms.) That was the case last year, and nobody had any problem with it, so I assume that it is still acceptable.

We'll make sure to copy you on the disposition spreadsheet.

>>>Robert Greisman 12/19/01 07:35 AM>>>
Michael:
Thanks. Based on a conversation with Larry today, I believe he plans on attending the signing party in Connecticut. I think that's important–to be sure Gramercy stays focused. I know the attention to this point has been documents. I'm sure you and Larry have a handle on it, but so I understand, at what point does the distressed debt investment partnership sell or exchange assets? What documents will we want to see to be sure that a sale or exchange has occurred at hat level? Do we care what the fund does with the cash proceeds from the sale of one of those assets? If it's not a sale, but an exchange, anything special we need to do to be sure it fits Cottage Savings?
Thanks for all your hard work on this.

Bob

>>>Michael Kerekes 12/19/01 01:08AM>>>
Larry, tomorrow I will make a priority of figuring out whether any more of the agreements on your "missing" list were sent to me by Gramercy (as was the MJENN Operating Agreement).

I will also have to get some kind of drafting done for Ng once that situation has been settled by Paul

Other than that, I believe the only documents requiring client signatures are:

IPAs:

[REDACTED]

Supplemental contributions:
Cuillo (Gottlieb)

[REDACTED]

Amended and Restated Op Agts:

[REDACTED]

[p.3]

Shanbrom has copies of everything he needs to get signed, although in some cases some blanks will need

to be filled in. Basically, I am assuming Paul will collect his signatures. If you are dealing with Huntzinger and Frischer and I am dealing with Gottlieb, we may be in pretty good shape.

Of course, we'll have to have a huge signing party with the Gramercy people in their various capacities. I think they'll have at least a couple of dozen documents to execute, plus all the corrected documents you are now generating. You may need to go up to Connecticut to furnish guidance.

One thing I want to make sure is that for all cash contributions that were previously made but still need to be documented (the initial contributions, that I refer to as the "14% Contributions"), Gramercy has the power to sign for the taxpayers. I believe this affects Cuillo, [REDACTED] Are we confident on this point?

Your comments?

Copies to Shanbrom so he knows wht I think he is doing and Greisman so he has a general handle on the work. Bob, this is only a list of what remains to be done. If you want details on what has been done (more than what you received in our earlier phone call), feel free to call.

cc: PSHANBROM.Detroit.003

APPENDIX G

Supreme Court of the United States
Office of the Clerk
Washington, DC 20543-0001

William K. Suter
Clerk of the Court
(202) 479-3011

September 27, 2007

Mr. David Decoursey Aughtry
Chamberlain, Hrdlicka, White, Williams & Martin
191 Peachtree Street, 34th Floor
Atlanta, GA 30303-1747

Re: Robert S. Cuillo, et al.
v. United States
Application No. 07A270

Dear Mr. Aughtry:

The application for an extension of time within which to file a petition for a writ of certiorari in the above-entitled case has been presented to Justice Stevens, who on September 27, 2007 extended the time to and including October 31, 2007.

This letter has been sent to those designated on the attached notification list.

Sincerely,

William K. Suter, Clerk

by

/s/
Jeffrey Atkins
Supervisor-Case Analyst Division

NOTIFICATION LIST

Mr. David Decoursey Aughtry
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191 Peachtree Street, 34th Floor
Atlanta, GA 30303-1747

Mr. Paul D. Clement
Solicitor General
United States Department of Justice
950 Pennsylvania Avenue, N.W.
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Clerk
United States Court of Appeals for the Seventh Circuit
219 S. Dearborn Street, Room 2722
Chicago, IL 60604

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(2)

No. 07-586

In the Supreme Court of the United States

ROBERT S. CUILLO, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

PAUL D. CLEMENT
Solicitor General
Counsel of Record
NATHAN J. HOCHMAN
Assistant Attorney General
JONATHAN S. COHEN
KENNETH W. ROSENBERG
Attorneys
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QUESTIONS PRESENTED

1. Whether the court of appeals correctly upheld the district court's determination that a particular document fell within the crime-fraud exception to the tax-practitioner privilege.

2. Whether the court of appeals correctly held that the tax-shelter exception to the tax-practitioner privilege, as it was codified at 26 U.S.C. 7525(b) (2000), was not limited to communications relating to corporate taxes.

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In the Supreme Court of the United States

No. 07-586

ROBERT S. CUILLO, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-50a) is reported at 492 F.3d 806. The opinions of the district court (Pet. App. 51a-59a, 60a-72a, 73a-111a) are reported at 95 A.F.T.R.2d 2005-1725 (RIA), 95 A.F.T.R.2d 2005-2835 (RIA), and 96 A.F.T.R.2d 2005-6318 (RIA).

JURISDICTION

The judgment of the court of appeals was entered on July 2, 2007. On September 27, 2007, Justice Stevens extended the time within which to file a petition for a writ of certiorari to and including October 31, 2007, and the petition was filed on that date. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. This case arises out of an action to enforce administrative summonses issued by the Internal Revenue Service (IRS) to BDO Seidman, LLP, a public accounting and consulting firm. At the time the summonses were issued, Section 6111(a) of the Internal Revenue Code (26 U.S.C.) required the organizers of certain tax shelters to register the shelters with the IRS. Any tax shelter that was required to be registered under Section 6111(a) was deemed to be "potentially abusive," as was any "arrangement which [was] of a type which the Secretary determine[d] by regulations as having a potential for tax avoidance or evasion." 26 U.S.C. 6112(b)(2) (2000).[1] The organizers and sellers of "potentially abusive" tax shelters also were required to maintain a list of the investors in such shelters and to make those lists available to the IRS upon request. A failure to comply with the registration and listing requirements of Sections 6111 and 6112 could result in monetary penalties. See 26 U.S.C. 6707, 6708 (2000).

2. In September 2000, the IRS received information suggesting that BDO Seidman was promoting potentially abusive tax shelters without complying with the registration and list-keeping requirements for organizers and sellers of such tax shelters. On May 2, 2002, pursuant to 26 U.S.C. 7602, the IRS issued 20 sum-

---

[1] Sections 6111 and 6112 were amended by the American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 815, 118 Stat. 1581-1583. The Act replaced the terms "tax shelter" in Section 6111 and "potentially abusive tax shelter" in Section 6112 with the term "reportable transaction." Reportable transactions are defined as transactions "of a type which the Secretary determines as having a potential for tax avoidance or evasion." 26 U.S.C. 6707A(c)(1) (Supp. IV 2004).

monses to BDO Seidman commanding production of documents and testimony relating to various potentially abusive tax shelters organized or sold by BDO Seidman, as well as information about clients of BDO Seidman who had invested in those tax shelters. BDO Seidman failed to produce the documents as required by the summonses. Gov't C.A. Br. 5.

On July 9, 2002, the government petitioned the district court for enforcement of the summonses pursuant to 26 U.S.C. 7402(b), 7604(a). BDO Seidman opposed enforcement on the grounds that the investigation lacked a legitimate purpose, the summonses were overbroad and issued in bad faith, and the information sought was already in the possession of the IRS and was not relevant to its investigation. The district court rejected those arguments and ordered BDO Seidman to produce all documents responsive to the summonses, except for documents the firm had listed on two privilege logs and submitted to the court for *in camera* review. Pet. App. 76a-77a; Gov't C.A. Br. 5-6.

Some of the responsive documents revealed the identities of clients of BDO Seidman who had invested in tax shelters. Two groups of those clients sought to intervene in the litigation, contending that their identities were protected from disclosure under 26 U.S.C. 7525, which creates a confidentiality privilege for certain communications between federally authorized tax practitioners and their clients. The district court held that information regarding a client's identity is outside the scope of the statutory privilege and denied the motions to intervene. After remanding the case to the district court for further findings, the court of appeals affirmed the denial of intervention. 337 F.3d 802 (2003). This Court denied the intervenors' petition for a writ of certiorari.

540 U.S. 1178 (2004). Pet. App. 77a-82a; Gov't C.A. Br. 6-7.

3. The district court then allowed the clients of BDO Seidman to intervene in their own names to assert objections to the firm's disclosure of documents responsive to the summonses. Pet. App. 83a. The intervenors asserted that 267 responsive documents were protected from disclosure by the tax-practitioner privilege at 26 U.S.C. 7525, the attorney-client privilege, and/or the work product doctrine; the intervenors submitted copies of those documents to the district court for *in camera* review. Pet. App. 74a-75a. The government argued, among other things, that the intervenors' privilege claims were defeated by two applicable exceptions, namely the common law crime-fraud exception and the statutory tax-shelter exception to the tax-practitioner privilege, 26 U.S.C. 7525(b) (2000). Gov't C.A. Br. 16-17. In support of its arguments, the government submitted a declaration of Revenue Agent Sandra Alvelo and additional exhibits. Pet. App. 94a.

On March 30, 2005, the district court ruled on the intervenors' privilege claims. Pet. App. 73a-111a. The court noted that it had reviewed the 267 documents *in camera*. *Id.* at 76a. The court determined that the documents "appear[ed] to fall within either the attorney-client, tax practitioner and/or work product privileges." *Id.* at 90a. In a footnote, the district court ruled that it could not conclude "at this stage in the litigation" that BDO Seidman and the intervenors were engaged in "tax shelters, as defined under [26 U.S.C. 6662(d)(2)(C)(ii) (Supp. IV 2004)]" and thus could not find that the statutory tax-shelter exception to the tax-practitioner privilege at 26 U.S.C. 7525(b) (2000) applied. Pet. App. 95a n.6.

The district court rejected the government's argument that the crime-fraud exception should be applied "as a blanket matter" to all 267 documents. Pet. App. 94a-95a. Instead, the district court reviewed the documents *in camera* to determine, "on a document-by-document basis," whether any individual documents fell within the crime-fraud exception. *Id.* at 95a-96a. The court stated that in conducting the *in camera* review, it would make "its own independent determination as to whether there [was] sufficient evidence to show * * * '(1) a *prima facie* showing of [a crime or] fraud, and (2) [that] the communications in question are in furtherance of the misconduct.'" *Id.* at 97a (second pair of brackets in original) (quoting *Vardon Golf Co.* v. *Karsten Mfg. Corp.*, 213 F.R.D. 528, 535 (N.D. Ill. 2003)).

The district court identified three recent cases in which federal courts had "attempt[ed] to address whether transactions produced and marketed by accounting, consulting and law firms were abusive tax shelters in violation[] of the tax code." Pet. App. 97a.[2] The district court viewed those cases as "a background from which the court [could] draw to identify potential indicators of fraud that could lead to a finding of [a] *prima facie* showing of a crime-fraud and communication in furtherance of the crime-fraud." *Ibid.* The district court identified eight "potential indicators of fraud" that would guide its determination of "whether the government can meet the *prima facie* test [for application

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[2] The three cases were *Denney* v. *Jenkens & Gilchrist*, 340 F. Supp. 2d 338 (S.D.N.Y. 2004), rev'd in part and vacated in part *sub nom. Denney* v. *BDO Seidman, LLP*, 412 F.3d 58 (2d Cir. 2005); *Miron* v. *BDO Seidman, LLP*, 342 F. Supp. 2d 324 (E.D. Pa. 2004); and *United States* v. *KPMG*, 316 F. Supp. 2d 30 (D.D.C. 2004).

of the crime-fraud exception] on an individual document-by-document basis":

> (1) the marketing of pre-packaged transactions by BDO; (2) the communication by the Intervenors to BDO with the purpose of engaging in a pre-arranged transaction developed by BDO or [a] third party with the sole purpose of reducing taxable income; (3) BDO and/or the Intervenors attempting to conceal the true nature of the transaction; (4) knowledge by BDO, or a situation where BDO should have known, that the Intervenors lacked a legitimate business purpose for entering into the transaction; (5) vaguely worded consulting agreements; (6) failure by BDO to provide services under the consulting agreement yet receipt of payment; (7) mention of the COBRA [Currency Options Bring Reward Alternatives] transaction; and (8) use of boiler-plate documents.

Id. at 102a-103a. The district court emphasized that it would not "limit itself to the indicators" in assessing whether a "*prima facie* case for the application of the crime-fraud exception" was presented, and that "an indication of potential fraud does not mean that fraud exists sufficient for a *prima facie* finding." *Id.* at 103a-104a. The court instead would consider the "totality of the circumstances" surrounding each document. *Id.* at 103a.

Following its *in camera* review, the district court concluded that "a *prima facie* case for the crime-fraud exception" had been established with respect to only one of the 267 documents, Document A-40. Pet. App. 104a, 114a-117a. That document is a December 19, 2001, electronic mail exchange among employees of BDO Seidman. The district court indicated that it was "specifically concerned" with the following statement in the ex-

change, which was authored by BDO Seidman employee Michael Kerekes (Kerekes): "I expect that Larry and I will provide Jay a list of losses to be triggered so we can make sure each client gets what he wants." *Id.* at 104a, 114a.

Pursuant to *United States* v. *Davis*, 1 F.3d 606 (7th Cir. 1993), cert. denied, 510 U.S. 1176 (1994), the district court required the intervenors "to provide an explanation as to why [Document A-40] should not be disclosed to the government under the crime-fraud exception." Pet. App. 104a-105a. The intervenors filed a memorandum in which they asserted that Document A-40 reflected an effort by BDO Seidman employees to accomplish their clients' "year end tax planning goals" with respect to "distressed" debt instruments in which the clients had invested. Gov't C.A. Combined Br. 8. The intervenors' submission included several articles concerning year-end tax planning and declarations from the BDO Seidman employees involved in the electronic mail exchange, Kerekes and Robert Greisman. *Id.* at 9.

The government filed a response that included a supplemental declaration executed by Revenue Agent Alvelo with supporting documents that had been produced by BDO Seidman. Gov't C.A. Combined Br. 9-10. The documents described the types of tax-shelter transactions at issue, one of which involved the transfer of a portfolio of "distressed" debt instruments (meaning debt instruments with a high basis but a low market value) from a foreign party to a domestic limited liability company taxed as a partnership, in exchange for a controlling interest in the partnership. Under 26 U.S.C 723, the partnership would retain the foreign party's high basis in the debt instruments. The foreign party then would sell all or almost all of its interest in the partner-

ship to a domestic taxpayer at a price substantially less than the partnership's basis in the distressed debt. Under 26 U.S.C. 743(a) (2000), the partnership's basis in the distressed debt would not change. When the distressed debt instruments were sold or exchanged (sometimes by lower-tier partnerships to which they had been contributed), the domestic taxpayer would realize the built-in loss from the transaction. Alvelo Fifth Supp. Decl. ¶¶ 53-63.[3] The Cuillo transaction described in Agent Alvelo's declaration was of this type, and the realized loss exceeded $20 million. *Id.* ¶¶ 58, 63. Through a "Consulting Agreement," Cuillo contracted to pay BDO Seidman $1.47 million for the tax-shelter product. *Id.* ¶ 55.

The documents also revealed BDO Seidman's worries about the need to obtain the protection of the attorney-client and tax-practitioner privileges for itself and its clients. Gov't C.A. Combined Br. 10. In one electronic mail message sent on April 27, 2001, Kerekes wrote that if BDO Seidman had an "argument" that the accountant-client privilege would extend to Helios (another entity involved in some of BDO Seidman's tax-shelter transactions)—which Kerekes acknowledged was "something of a long shot"—Kerekes "wouldn't mind litigating it for a couple of years while statutes [of limitations] run." Alvelo Fifth Supp. Decl. ¶ 39. The government's submission also demonstrated that the intervenors had purchased distressed-debt "investments" near the end of the year and had disposed of their "investments" shortly thereafter, in order to generate a capital loss in the same year of the investment. Gov't C.A. Combined Br.

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[3] See Internal Revenue Service, *Coordinated Issue Paper—Distressed Asset/Debt Tax Shelters*, 2007 WL 1511543 (Apr. 18, 2007).

10. The government also directed the district court to a May 2, 2001, memorandum drafted by Kerekes, in which Kerekes indicated that if the distressed debt packages at issue were "subject to the 'marking-to-market rules'" under the Internal Revenue Code, that "would of course render [them] useless for our purposes." *Id.* at 10-11.[4]

On May 17, 2005, the district court ruled that the intervenors had "failed to provide [a] sufficient explanation to rebut this court's finding of a *prima facie* case for the application of the crime-fraud exception for [D]ocument A-40." Pet. App. 60a-61a. Based on Agent Alvelo's declaration and the supporting materials submitted by the government, the district court found that "the immediate activity in [the] transaction was for [intervenor Cuillo] to obtain a loss." *Id.* at 69a. The district court noted that Cuillo's initial investment in the distressed debt had occurred in late 2001, "the same period in which [Cuillo] was looking to receive the loss." *Ibid.* The court found that the timing of the investment "contradict[ed]" the intervenors' "claim that their primary purpose for investing in these transactions was the hope of making a profit." *Ibid.* The court also found that the May 2, 2001, memorandum drafted by Kerekes—in which Kerekes indicated that a "marking-to-market requirement" would render the distressed debt

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[4] The district court subsequently explained that "[m]arking a security to market value requires the revaluing of the security from its book value to fair market value" and that the "effect of the 'marking-to-market' on 'distressed debt' would mean the elimination of a potential deductible tax loss." Pet. App. 69a-70a. As noted *supra*, an essential component of the distressed debt transactions at issue was the transfer to the domestic partnership of the foreign party's high tax basis in the underlying debt instruments; the high basis ultimately enabled the domestic taxpayer to claim a large tax loss when the instruments were sold or exchanged.

packages "useless for our purposes"—further supported the conclusion that "the sole motive [of the transactions at issue] was to obtain a loss." *Id.* at 70a-71a. The district court noted that the May 2, 2001, memorandum was the first document it had viewed that suggested that the transactions at issue had the "sole purpose" of obtaining a loss. *Id.* at 71a. Moreover, the court concluded that the intervenors had "failed to provide any explanation in their briefs or supporting documentation to overcome the government's position that this particular transaction is in violation of the Internal Revenue Code." *Id.* at 70a. Accordingly, the court concluded that "the crime-fraud exception must be applied to [D]ocument A-40 and therefore a claim of privilege cannot be used to prevent the disclosure of [D]ocument A-40 to the IRS under the IRS's civil subpoenas." *Id.* at 72a.

4. The intervenors filed a motion under Federal Rule of Civil Procedure 60(b) for relief from the district court's May 17, 2005, order. Pet. App. 51a. The intervenors informed the court that the Second Circuit had reversed the judgment in *Denney* v. *Jenkens & Gilchrist*, 340 F. Supp. 2d 338 (S.D.N.Y. 2004), rev'd in part and vacated in part *sub nom. Denney* v. *BDO Seidman, LLP*, 412 F.3d 58 (2d Cir. 2005). Because the district court had relied in part on the district court's opinion in *Denney*, the intervenors asked the court to reexamine its ruling on Document A-40. Pet. App. 53a. The district court denied the motion, noting that the court "did not rely on the Southern District of New York's *Denney* decision as controlling case law in either the March 30th or May 17th opinions." *Id.* at 53a-54a.

5. The IRS appealed from the district court's determination that the documents for which the intervenors claimed privilege were protected by the statutory tax-

practitioner privilege, 26 U.S.C. 7525 (2000).[5] The intervenors cross-appealed from the district court's finding that Document A-40 fell within the crime-fraud exception. Pet. App. 2a.

With respect to Document A-40, the Seventh Circuit ruled that "the district court did not abuse its discretion when it concluded that the IRS had made a prima facie showing of crime or fraud which the Intervenors failed to explain satisfactorily." Pet. App. 29a. The court of appeals noted that in the Seventh Circuit, the party seeking to invoke the crime-fraud exception "must present prima facie evidence that 'gives colour to the charge' by showing 'some foundation in fact.'" *Id.* at 25a (quoting *United States* v. *Al-Shahin*, 474 F.3d 941, 946 (7th Cir. 2007), and *Clark* v. *United States*, 289 U.S. 1, 15 (1933) (internal quotation marks omitted)). The court explained that a party meets that initial burden by "bringing forth sufficient evidence to justify the district court in requiring the proponent of the privilege to come forward with an explanation for the evidence offered against it." *Ibid.* (citing *Davis*, 1 F.3d at 609). The privilege remains "if the district court finds [the] explanation satisfactory." *Ibid.*

The court of appeals rejected the argument that the party asserting the crime-fraud exception must "make out a prima facie case of each element of a particular crime or common law fraud." Pet. App. 25a. The court stated that such an approach "reflect[ed] the view of some circuits, which require enough evidence of crime or fraud to support a verdict in order to invoke the crime-

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[5] The IRS also appealed from the district court's ruling sustaining BDO Seidman's claim of attorney-client privilege with respect to a memorandum written by one of BDO's employees. Pet. App. 2a. That issue is not raised in the petition.

fraud exception." *Ibid.* The court noted that the Seventh Circuit instead required "that the party seeking to abrogate the privilege need only 'give colour to the charge' by showing 'some foundation in fact.'" *Ibid.* (citations omitted). The court of appeals concluded that the district court had acted within its discretion when it found that the IRS had made a *prima facie* showing that Document A-40 was a communication made in furtherance of a crime or fraud and, after offering the intervenors the opportunity to explain the communication, rejected the explanation as not satisfactory. *Id.* at 29a.

With respect to the applicability of the tax-practitioner privilege of 26 U.S.C. 7525(a)(1) (2000),[6] and in particular the scope of the then-applicable tax-shelter exception to the privilege codified at 26 U.S.C. 7525(b) (2000),[7] the court of appeals held that the opponent of

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[6] Section 7525(a)(1) provides:

> With respect to tax advice, the same common law protections of confidentiality which apply to a communication between a taxpayer and an attorney shall also apply to a communication between a taxpayer and any federally authorized tax practitioner to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney.

26 U.S.C. 7525(a)(1) (2000).

[7] The tax-shelter exception provided:

> The privilege under subsection (a) shall not apply to any written communication between a federally authorized tax practitioner and a director, shareholder, officer, or employee, agent, or representative of a corporation in connection with the promotion of the direct or indirect participation of such corporation in any tax shelter (as defined in Section 6662(d)(2)(C)(iii)).

26 U.S.C. 7525(b) (2000).

the privilege—here, the IRS—bears the burden of establishing that a communication falls within the exception. Pet. App. 31a-35a. The court then rejected the intervenors' argument that the tax-shelter exception "applie[d] only to tax shelters that shelter corporate taxes." *Id.* at 36a. The court explained that "[t]he plain text appears to apply to any tax shelter falling within the definition of a tax shelter found at 26 U.S.C. § 6662(d)(2)(C)(ii)." *Id.* at 36a-37a.

The court of appeals rejected the intervenors' argument that subsection (b)'s heading—which read at that time, "[s]ection not to apply to communications regarding corporate tax shelters"—demonstrated a congressional intent to limit the scope of the exception to tax shelters for corporate income taxes. The court observed that "[a]s a general rule, [t]he title of a statute . . . cannot limit the plain meaning of the text." Pet. App. 37a (internal quotation marks and citations omitted). The court then concluded that "subsection (b) is not ambigu-

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In 2004, Section 7525(b) was amended in several respects. The heading of the subsection (which formerly read, "Section not to apply to communications regarding corporate tax shelters") now reads, "Section not to apply to communications regarding tax shelters." American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 813(a), 118 Stat. 1581. That change was effective for communications made after October 22, 2004. In addition, the 2004 amendments substituted the word "person" for "corporation" in the text of the subsection and thus eliminated any requirement that a corporation be involved in the written communications covered by the tax-shelter exception. *Ibid.* Third, because the definition of "tax shelter" found at 26 U.S.C. 6662(d)(2)(C)(iii) (2000) was moved to 26 U.S.C. 6662(d)(2)(C)(ii) (Supp. IV 2004), § 812(d), 118 Stat. 1580, a corresponding change was made to Section 7525(b), § 813(a), 118 Stat. 1581. For ease of reference, the court of appeals referred to the more recent Code section containing the "tax shelter" definition (Pet. App. 36a n.13). This brief does likewise.

ous. If anything, the heading adds ambiguity to subsection (b). Absent this heading, the subsection would not seem limited to corporate tax shelters at all." *Ibid.*

The court of appeals also noted that, although the heading relied upon by the intervenors "suggests that Congress had corporate tax shelters in mind, 'the fact that a statute can be applied in situations not expressly anticipated by Congress' demonstrates breadth, not ambiguity." Pet. App. 38a (citations omitted). The court emphasized the breadth of the language of the tax-shelter exception, noting that it applied to "*any* written communication . . . in connection with the promotion of the direct or indirect participation of such corporation in *any* tax shelter." *Ibid.* The court also noted that Congress elected to refer to the "relatively broad" definition of "tax shelter" found at 26 U.S.C. 6662(d)(2)(C)(ii) (Supp. IV 2004),[8] rather than to the narrower definitions in the pre-2004 version of 26 U.S.C. 6111 (2000). *Ibid.* The court further concluded that the legislative history on which the intervenors relied "raise[d] more questions than it answers." *Id.* at 39a. And the court rejected the intervenors' claim that application of the tax-shelter exception to tax shelters that do not involve corporate income taxes would destroy the privilege any time a corporation participates in any way in a tax shelter. *Id.* at 45a. The court emphasized that the exception was limited by its terms to written communications between a federally authorized tax practitioner and particular corporate agents, and that the written communication must "relate[] to the corporation's direct or indirect participa-

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[8] That definition includes "any partnership, entity, plan or arrangement, a significant purpose of which is the avoidance or evasion of Federal income tax." Pet. App. 38a (quoting 26 U.S.C. 6662(d)(2)(C)(ii) (Supp. IV 2004)).

tion in a particular type of tax shelter, i.e., one meeting the definition found in § 6662(d)(2)(C)(ii)." *Ibid.*

Because the district court failed to make clear what legal standard it had applied in determining that the tax-shelter exception was inapplicable, the court of appeals vacated the district court's ruling on the tax-shelter exception and remanded for further consideration. Pet. App. 48a-49a. The court directed the district court on remand (1) to determine, for each of the 266 documents at issue, whether the attorney-client privilege, the tax-practitioner privilege, or both privileges, applied; and (2) for documents protected by the tax-practitioner privilege only, to permit the IRS to attempt to demonstrate the applicability of the tax-shelter exception. *Id.* at 49a.

ARGUMENT

Petitioners seek review of the court of appeals' factbound ruling upholding the district court's application of the crime-fraud exception to a single document. Further review of that ruling is unwarranted. Although the courts of appeals have articulated somewhat different verbal formulations of the evidentiary showing required to overcome a claim of privilege under the crime-fraud exception, the differences in wording do not warrant this Court's intervention. Under any of the formulations, the determination of whether the crime-fraud exception applies is highly fact-based; as a result, there is no basis on which to conclude that the circuits' varying formulations create a true conflict by yielding different results on equivalent facts. Review of that question is particularly unwarranted in this case, where only a single document is at issue and where the record before the

district court would satisfy the crime-fraud exception under any articulation of the evidentiary standard.

Petitioners also seek review of the court of appeals' determination that the pre-2004 version of the tax-shelter exception to the statutory tax-practitioner privilege was not limited to tax shelters designed to evade the payment of *corporate* income tax. Further review of that narrow issue is unwarranted. The court's decision is correct, it relies on longstanding precedent of this Court, petitioners identify no conflict among the circuits, and the issue is of limited and diminishing significance in light of the 2004 amendment to the statute, which eliminated the language on which petitioners rely.

1. Petitioners contend (Pet. 7-27) that the court of appeals erred in using a "totality of the circumstances" standard to determine whether the requirements of the crime-fraud exception had been satisfied, and that the circuits are meaningfully divided over the question of the proper evidentiary standard that should govern that question. Petitioners' contentions are without merit.

a. Like other privileges or immunities, the attorney-client privilege stands in derogation of the public's "right to every man's evidence," 8 John H. Wigmore, *Evidence* § 2192, at 70 (1961) (Wigmore), and as "an obstacle to the investigation of the truth." *Id.* § 2291, at 554. Accordingly, the privilege "ought to be strictly confined within the narrowest possible limits consistent with the logic of its principle." *Ibid.*; see *United States* v. *Zolin*, 491 U.S. 554, 562 (1989) ("[s]ince the privilege has the effect of withholding relevant information from the factfinder, it applies only where necessary to achieve its purpose") (quoting *Fisher* v. *United States*, 425 U.S. 391, 403 (1976)); *University of Pa.* v. *EEOC*, 493 U.S.

182, 189 (1990) (privileges that obstruct the truth-finding process must be construed narrowly).

When a client, intending to violate basic legal obligations, consults an attorney in furtherance of those intentions, there is less societal interest in protecting the communication. The attorney-client privilege accordingly does not extend to advice in aid of future wrongdoing. 8 Wigmore § 2298, at 573. In particular, the privilege does not apply to a communication where a client "uses the lawyer's advice or other services to engage in or assist a crime or fraud." Restatement (Third) of the Law Governing Lawyers § 82(b) at 614 (2000); see Supreme Court Standard 503(d)(1) (1972), in 56 F.R.D. 184, 236 (1973) (there is no privilege "[i]f the services of the lawyer were sought or obtained to enable or aid anyone to commit or plan to commit what the client knew or reasonably should have known to be a crime or fraud");[9] *In re Green Grand Jury Proceedings*, 492 F.3d 976, 980 (8th Cir. 2007) ("Although there is a societal interest in enabling clients to get sound legal advice, there is no such interest when the communications or advice are intended to further the commission of a crime or fraud.") (quoting *In re Richard Roe, Inc.*, 68 F.3d 38, 40 (2d Cir. 1995)); *In re Antitrust Grand Jury*, 805 F.2d 155, 162 (6th Cir. 1986) ("All reasons for the attorney-client privilege are completely eviscerated when a client consults an attorney not for advice on past misconduct, but for legal assistance in carrying out a contemplated or ongoing crime or fraud.").

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[9] Although Supreme Court Standard 503 was not enacted by Congress, it is "an excellent distillation of the principles governing application of the privilege." 3 Joseph M. McLaughlin, *Weinstein's Federal Evidence* 503-1 (2d ed. 1997).

This Court addressed the crime-fraud exception in *Clark* v. *United States*, 289 U.S. 1 (1933). *Clark* involved a juror who was convicted of criminal contempt based on misleading and false answers that the juror provided during voir dire concerning her qualifications to serve. The issue before the Court was whether the admission of testimony concerning the juror's conduct during deliberations was "a denial or impairment of any lawful privilege." *Id.* at 12. Assuming the existence of a privilege protecting jury deliberations, the Court concluded that "the privilege does not apply where the relation giving birth to it has been fraudulently begun or fraudulently continued." *Id.* at 14. The Court analogized the situation before it to the crime-fraud exception to the attorney-client privilege:

> There is a privilege protecting communications between attorney and client. The privilege takes flight if the relation is abused. A client who consults an attorney for advice that will serve him in the commission of a fraud will have no help from the law. He must let the truth be told. * * * It is obvious that it would be absurd to say that the privilege could be got rid of merely by making a charge of fraud. To drive the privilege away, there must be something to give colour to the charge; there must be *prima facie* evidence that it has some foundation in fact. When that evidence is supplied, the seal of secrecy is broken.

Id. at 15 (internal quotation marks and citations omitted).

b. The court below drew its standard for the crime-fraud exception directly from *Clark*. In *In re Feldberg*, 862 F.2d 622 (7th Cir. 1988), the court of appeals held

that "[t]o drive the privilege away, there must be something to give colour to the charge [of fraud or criminality]; there must be *prima facie* evidence that it has some foundation in fact." *Id.* at 625 (citations and internal quotation marks omitted). When such a *prima facie* showing is made, the adverse party—"the one with superior access to the evidence and in the best position to explain things"—is required "to come forward with that explanation." *Id.* at 625-626.[10] And "[i]f the court finds the explanation satisfactory, the privilege remains." *Id.* at 626. Accord, *Al-Shahin*, 474 F.3d at 946-947; *Davis*, 1 F.3d at 609. This Court has previously declined to review the standard employed by the court of appeals. See *Davis* v. *United States*, 510 U.S. 1176 (1994) (No. 93-900). The same result is appropriate here.

Although petitioners assert (Pet. 11) that the court of appeals' standard permits district courts to "apply[] an *ipse dixit* standard with no need to identify anything more than suspicions about unidentified wrongs," case law does not support petitioners' dire characterization. Indeed, petitioners concede (Pet. 23) that in *Al-Shahin*, *supra*, the court of appeals "took pains to cite the extensive independent evidence of the identified mail fraud" that supported application of the crime-fraud exception in that case. See *Al-Shahin*, 474 F.3d at 946-947. Petitioners similarly acknowledge (Pet. 23) that in *Feldberg*, the court also "took pains" to "point to ample independent evidence" of obstruction of justice as a basis for pos-

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[10] The Seventh Circuit analogized the "*prima facie* case" requirement in the setting of the crime-fraud exception to the role of a "*prima facie* case" in discrimination cases. *Feldberg*, 862 F.3d at 626 (citing *Texas Dep't of Cmty. Affairs* v. *Burdine*, 450 U.S. 248, 254 n.7 (1981)).

sible application of the crime-fraud exception in that case. See *Feldberg*, 862 F.2d at 625.

The same is true in this case. Petitioners' abstract concerns about the court of appeals' standard do not justify review, because the ruling on the crime-fraud exception as applied to Document A-40 was not based on mere "suspicions about unidentified wrongs" (Pet. 11). The district court rendered its ruling only after receiving lengthy evidentiary submissions by the parties on the question whether Document A-40 was a communication made in furtherance of a crime or fraud. In its ruling, the district court made clear that it had been presented with independent evidence demonstrating that the "sole motive" of the distressed-debt transaction discussed in Document A-40 was "to obtain a loss." Pet. App. 70a-71a. Petitioners fail even to acknowledge that evidence, which included the May 2, 2001, memorandum by Kerekes indicating that the distressed debt packages would be "useless for our purposes" if the securities were required to be revalued to fair market value (thereby eliminating the high basis required to generate a tax "loss"), and the fact that the "investments" were made shortly before the taxpayer intended to record a loss. *Id.* at 69a-71a. Against that evidentiary backdrop, the statement contained within Document A-40 itself—"I expect that Larry and I will provide Jay a list of losses to be triggered so we can make sure each client gets what he wants" (*id.* at 114a)—further indicated that petitioners and their tax practitioners were engaged in transactions based not on economic reality, but instead designed solely to create an artificial appearance of tax losses, and that the communications with tax practitioners at BDO Seidman were made in furtherance of that fraudulent conduct.

Even measured against the standard for the crime-fraud exception that petitioners urge upon the Court (Pet. 8)—"(i) identification of the specific crime-fraud alleged and (ii) evidence as to the essential elements" —petitioners cannot show that the evidence here was inadequate. The statement in Document A-40 on which the district court focused—which was analogous to a response of "how much do you want it to be?" to the question "how much is two p[illegible]s two?"—was evidence of a plan to submit fraudulent or false information on tax returns. See 26 U.S.C. 7206(2) ("Any person who * * * [w]illfully aids or assists in, or procures, counsels, or advises the preparation or presentation under * * * the internal revenue laws, of a return * * * which is fraudulent or is false as to any material matter" shall be guilty of a felony.); *United States* v. *Ragen*, 314 U.S. 513, 518-521 (1942) (characterization of payments as deductible "commissions," supported by falsified documents, supported conviction for tax fraud); *Bryan* v. *Commissioner*, 209 F.2d 822, 828 (5th Cir. 1954) (method of bookkeeping "designed to conceal the true facts concerning taxable income" warranted finding that false returns were filed with the intent to evade tax), cert. denied, 348 U.S. 912 (1955); *Drobny* v. *Commissioner*, 86 T.C. 1326, 1350 (1986) (fraud penalty upheld where economics of purported research partnership, including deductions greatly in excess of amount invested, made conclusion "inescapable" that taxpayer knew "that the funds for which he claimed deductions would not in fact be used for research"); 1 Ian M. Comisky et al., *Tax Fraud and Evasion* ¶ 8.02[3][f][iii], at 8-21 (6th ed. 2007) ("Fraudulent intent can be inferred from wrongful overstatement of a deduction or the claiming of an unallowable exemption or credit."). Because petitioners demon-

strate no error in the court of appeals' ruling upholding application of the crime-fraud exception to Document A-40, further review is not warranted.

c. Petitioners also ask this Court to "resolve the disagreements between the Courts of Appeal" concerning the level of proof required to support application of the crime-fraud exception (Pet. 27), and to establish a "simple, consistent crime-fraud rule" to apply in all circuits (Pet. 2). Petitioners are correct that the courts of appeals have articulated somewhat different verbal formulations of the evidentiary showing required to overcome a claim of privilege under the crime-fraud exception. See, *e.g.*, *In re Sealed Case*, 676 F.2d 793, 815 (D.C. Cir. 1982) (evidence that "if believed by a trier of fact, would establish the elements of some violation that was ongoing or about to be committed"); *In re Grand Jury Proceedings*, 87 F.3d 377, 381 (9th Cir.) ("reasonable cause to believe that the attorney's services were utilized . . . in furtherance of the ongoing unlawful scheme") (internal quotation marks and citation omitted), cert. denied, 519 U.S. 945 (1996); *In re Richard Roe, Inc.*, 68 F.3d at 40 ("probable cause to believe that a crime or fraud has been attempted or committed and that the communications were in furtherance thereof"); *Haines* v. *Liggett Group Inc.*, 975 F.2d 81, 95-96 (3d Cir. 1992) ("evidence which, if believed by the fact-finder, would be sufficient to support a finding that the elements of the crime-fraud exception were met"); *In re Grand Jury Investigation*, 842 F.2d 1223, 1226 (11th Cir. 1987) ("evidence that, if believed by a trier of fact, would establish the elements of some violation that was ongoing or about to be committed"); *In re International Sys. & Controls Corp. Sec. Litig.*, 693 F.2d 1235, 1242 (5th Cir. 1982) (relying on *Black's Law Dictionary* 1353 (4th ed. rev. 1968), "[evi-

dence] [s]uch as will suffice until contradicted and overcome by other evidence[;] . . . [a] case which has proceeded upon sufficient proof to that stage where it will support [a] finding if evidence to the contrary is disregarded"); *In re Antitrust Grand Jury*, 805 F.2d 155, 165-166 (6th Cir. 1986) (adopting Second Circuit's probable cause standard).

In *Zolin*, this Court declined to address "the quantum of proof necessary ultimately to establish the applicability of the crime-fraud exception." 491 U.S. at 563. And it is not necessary or appropriate for the Court to address that question in this case. Although the courts of appeals have acknowledged their differing articulations of the evidentiary standard under the crime-fraud exception, they also have recognized that those variations reflect differences in form rather than in substance. See *In re Grand Jury Proceedings*, 417 F.3d 18, 23 (1st Cir. 2005) ("The circuits—although divided on articulation and on some important practical details—all effectively allow piercing of the privilege on something less than a mathematical (more likely than not) probability that the client intended to use the attorney in furtherance of a crime or fraud. This is a compromise based on policy but so is the existence and measure of the privilege itself."), cert. denied, 546 U.S. 1088 (2006). See also *In re Antitrust Grand Jury*, 805 F.2d at 165-166 ("there are no practical differences between the probable cause standard and the *prima facie* standards formulated in the circuits"); *In re International Sys. & Controls Corp.*, 693 F.2d at 1242 n.11 (while another court used a "probable cause" standard rather than a "prima facie" case of crime or fraud, "[w]e think that while the court's phraseology is different, its approach was the same"). Because the application of the crime-

fraud exception is highly fact-based and committed in large part to the discretion of the district court, there is no actual conflict among the circuits—evidenced by differing results reached on comparable facts—that warrants this Court's intervention. Indeed, this Court has previously declined to address the question presented here, and there is no reason for a different result in this case. See *In re Grand Jury Proceedings*, 546 U.S. 1088 (2006) (No. 05-415); *Davis* v. *United States*, 510 U.S. 1176 (1994) (No. 93-900).

Nor is this case an appropriate vehicle for reaching the broader question of the evidentiary standard for the crime-fraud exception. The disclosure of only a single document is at issue and, as already discussed, the court of appeals' ruling upholding the application of the crime-fraud exception was supported by a detailed evidentiary record developed after a full opportunity for petitioners to contest application of the exception. This case also is in an interlocutory posture, which further weighs against granting review. See *VMI* v. *United States*, 508 U.S. 946 (1993) (Court generally awaits final judgment in lower courts before exercising certiorari jurisdiction).[11]

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[11] Petitioners invoke (Pet. 9-10) the asserted need to protect the "reputation and integrity" of attorneys and tax professionals as a reason to grant review, and they refer the Court (Pet. 7) to *Arthur Andersen LLP* v. *United States*, 544 U.S. 696 (2005). See also Pet. 22 (characterizing application of crime-fraud exception as "scarring someone for life"); Pet. 27 ("the incredibly corrosive crime-fraud scar"). Petitioners err in conflating the crime-fraud exception with a judicial determination of actual wrongdoing. The crime-fraud exception merely lifts a privilege that shields evidence pertinent to an investigation from judicial scrutiny. Application of the exception to a particular document does not constitute an adjudication that any individual is guilty of a crime or fraud. See *In re Grand Jury Sub-*

2. Petitioners also seek review of the court of appeals' holding that the statutory tax-shelter exception to the tax-practitioner privilege, 26 U.S.C. 7525(b) (2000), as it existed before 2004, was not limited to communications relating to corporate taxes (Pet. 27-38). That holding does not conflict with any decision of this Court or of any court of appeals, and review therefore is not warranted. Moreover, the issue is of limited and diminishing significance. Petitioners' claim relies entirely on the heading of the pertinent subsection as it existed before 2004. As petitioners acknowledge (Pet. 35-37), the language on which they rely no longer is part of the statute. Indeed, as amended in 2004, the provision eliminates any limitation to communications involving corporations, thus making clear that the tax-shelter exception applies across the board to all written communications involving covered tax shelters. This Court's review is not warranted on a narrow question of statutory interpretation concerning language that has been superseded by a subsequent amendment.

Petitioners also demonstrate no error in the court of appeals' ruling that the unambiguous language of the pre-2004 statute—which incorporated by reference a specific statutory definition of "tax shelter" not limited to corporate taxes—controls, even over an allegedly narrower statutory title or heading. This Court laid that question to rest many years ago:

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poenas, 144 F.3d 653, 661 n.3 (10th Cir.) (although crime-fraud exception applied, "[w]e by no means imply that Doe and Roe are guilty of any crimes or that they were, in fact, culpable in any way"), cert. denied, 525 U.S. 966 (1998); see also *United States* v. *Bisceglia*, 420 U.S. 141, 146 (1975) (the purpose of an IRS summons "is not to accuse, but to inquire"). Petitioners' exaggerated description of the impact of the crime-fraud exception does not support review.

> [H]eadings and titles are not meant to take the place of the detailed provisions of the text. Nor are they necessarily designed to be a reference guide or a synopsis. Where the text is complicated and prolific, headings and titles can do no more than indicate the provisions in a most general manner; to attempt to refer to each specific provision would often be ungainly as well as useless. As a result, matters in the text which deviate from those falling within the general pattern are frequently unreflected in the headings and titles. Factors of this type have led to the wise rule that the title of a statute and the heading of a section cannot limit the plain meaning of the text. For interpretative purposes, they are of use only when they shed light on some ambiguous word or phrase. They are but tools available for the resolution of a doubt. But they cannot undo or limit that which the text makes plain.

Brotherhood of R.R. Trainmen v. *Baltimore & Ohio R.R.*, 331 U.S. 519, 528-529 (1947) (citations omitted). See *Pennsylvania Dep't of Corr.* v. *Yeskey*, 524 U.S. 206, 212 (1998); *Almendarez-Torres* v. *United States*, 523 U.S. 224, 234 (1998). Petitioners' argument that this Court's jurisprudence in this area is limited to circumstances "when publishers injected titles never enacted by Congress" was not presented to the court of appeals and finds no support in the opinions of this Court.[12]

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[12] Petitioners also err in contending (Pet. 31-32) that the circuits are divided over the question of when a title contemporaneously enacted as part of the original statute may be consulted as an aid to interpreting statutory text. Although petitioners contend that the District of Columbia and Fifth Circuits endorse the consideration of a statutory title as an aid to statutory interpretation in the

And, contrary to petitioners' further assertions (Pet. 28-29, 35-38), the legislative history of the 2004 amendment of the statute, which eliminated the word "corporate" from the title of Section 7525(b) and substituted the word "person" for the word "corporation" in the statutory text, has no bearing on the proper interpretation of the predecessor statute. See *O'Gilvie* v. *United States*, 519 U.S. 79, 90 (1996) ("the view of a later Congress cannot control the interpretation of an earlier enacted statute"). Further review is unwarranted.

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absence of ambiguity in statutory text, both circuits have made clear that they follow this Court's clear jurisprudence in this area. See *United States* v. *Morganfield*, 501 F.3d 453, 459 (5th Cir. 2007) ("For interpretative purposes, [titles] are of use only when they shed light on some ambiguous word or phrase.") (quoting *Brotherhood of R.R. Trainmen*, 331 U.S. at 529), petition for cert. pending, No. 07-8647 (filed Jan. 4, 2008)); *Murphy Exploration & Prod. Co.* v. *United States Dep't of the Interior*, 252 F.3d 473, 481 (D.C. Cir. 2001) (same) (quoting *Yeskey*, 524 U.S. at 212)). Moreover, neither case cited by petitioners applies a different rule. In both *Hardin* v. *City Title & Escrow Co.*, 797 F.2d 1037 (D.C. Cir. 1986), and *House* v. *Commissioner*, 453 F.2d 982 (5th Cir. 1972), the courts consulted statutory subtitles to resolve disagreements between the parties about the meaning of statutory text, and it is fair to infer that both courts viewed the statutory text as sufficiently ambiguous to warrant resort to other indications of legislative intent. See *Hardin*, 797 F.2d at 1039-1040 (use of the word "jurisdiction" in the title of the statute at issue supported the conclusion that the time limitation in the text of the statute was also intended to be jurisdictional); *House*, 453 F.2d at 987 (where subheading of statute does not destroy clear meaning of body of statute, it is proper to consult heading "to come up with the statute's clear and total meaning"; the subheading of the statute at issue informed the meaning of the term "interest" in the statutory text).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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No. 07-586

In The
Supreme Court of the United States

ROBERT S. CUILLO, et al.,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

PETITIONERS' REPLY BRIEF

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PETITIONERS' REPLY BRIEF

A. RARELY HAS THIS COURT FACED SO BROAD, SO IMPORTANT, AND SO LONG NEGLECTED A NEED THAN RESOLUTION OF THE FOUR-WAY CRIME/FRAUD CONFLICT.

The now acknowledged four-way split in the circuits, the tacit admission that the IRS never before posited its recent hypothesis, the radical difference between a timely-identified charge and shadowboxing, and the need for a consistent rule at the finger tips of every practitioner – all cry out for clarity.

1. The Government Concedes the Four-Way Split in the Circuits on this Essential Rule but Misses the Mark as to Its Significance.

If appellate judges splinter this everyday rule into four fractured pieces, what hope can a law student, a CPA, or a lawyer with a rural or national practice harbor? The Government not only misses the mark as to the need for a simple, consistent rule at the fingertips of every aspiring or struggling practitioner. The Government also misses the mark as to the dangerous divide that this case demonstrates.

Fortunately, the Government embraces our position that courts regularly specify both the crime/fraud and ample independent evidence of each of its elements. (Opp. 19-20). Only in that way, can a party marshal a meaningful response to what would otherwise be a vaporous allegation. Contrast that practice, however,

to how the Seventh Circuit's no-identified-wrong rule forces clients to shadow box:

> As we already have noted, ***our case law does not require a party*** seeking to invoke the crime-fraud exception ***to allege a particular offense or to make a prima facie showing*** with respect to each element of common law fraud. Pet. App. 28a (emphasis added).

The Government begs the question about the radical difference between an identified crime/fraud and no identified crime/fraud by resorting to those cases that note the similarity between probable cause, reasonable cause, and *prima facie* proof. (Opp. at 22-23). Those cases that attempt to reconcile the varying standards, however, all reach the exact opposite conclusion embraced by the Seventh Circuit – that is, the party asserting the exception must tender sufficient evidence of the elements that, if believed by the fact finder, would support a finding of crime/fraud. *See, e.g., Haines v. Liggett Group, Inc.*, 975 F.2d 81, 95-6 (3rd Cir. 1992).

This case demonstrates the danger in missing the critical distinction between unidentified and identified charges. Consider the chronology here in judging how easily someone can be scarred for life by a single misinterpreted email.[1]

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[1] With all due respect, the Government's insensitivity to the impact of a reckless crime/fraud allegation by the Government reflects the false comfort of someone who has not yet been falsely accused in a public forum. Footnote 11 of the Opposition drives

- July 29, 2004 – The Clients and their advisors tendered 267 documents for *in camera* review, including the documents the District Court later confirmed reflected profit motive.

- March 30, 1995 – With no identification of any crime/fraud or its elements, the District Court directed the Clients to one sentence in an email which dealt with triggering desired year-end losses. That email also specifically relied upon this Court's precedent in *Cottage Savings Ass'n. v. Commissioner*, 499 U.S. 554 (1991). Nowhere did the District Court (or the Government in its submissions) identify the charge, its elements, or the nature of the District Court's concern.

- April 14, 2005 – The Clients guessed that the Court's concern was the practice of triggering losses at year-end and tendered both affidavits and treatise excerpts relating to that common practice.

- May 15, 2005 – ***After the Clients responded***, the District Court indicated for the first time that it was concerned about "sole purpose" and that the Clients failed to

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home the importance of this point. The Government cavalierly dismisses the impact of an unfounded crime/fraud determination in the face of the harsh lesson the Government forced on the 26,000 employees of Arthur Andersen – it is the allegation that kills first.

> address that concern. Again, the Court failed to identify a crime or fraud, or explain how the email constituted *prima facie* evidence regarding its elements.

Had the Court identified a crime or fraud or even specified its "sole purpose" concern, the Clients could have easily addressed those concerns (as the discussion in the next section confirms). Instead, the Seventh Circuit rule left them guessing.

Practitioners deserve better and the D.C., Third, Fifth, Ninth, and Eleventh Circuits provide more. In these Circuits, not only must a party identify the particular crime or fraud furthered by the communication, he must also present independent evidence as to each element of that identified crime/fraud that, if left unrefuted, would sustain the underlying charge. *See, e.g., In re Sealed Case*, 676 F.2d 793, 815 (D.C. Cir. 1982); *Haines*, 975 F.2d at 95-6; *In re Grand Jury Subpoena*, 419 F.3d 329, 336 (5th Cir. 2005); *United States v. Chen*, 99 F.3d 1495, 1503 (9th Cir. 1996); *In re Grand Jury Investigation*, 842 F.2d 1223, 1226 (11th Cir. 1987). These cases remain true to the Supreme Court precedent over the past 75 years that focuses upon "the charge." *Clark v. United States*, 289 U.S. 1, 15 (1933). Especially when faced with an allegation as destructive as crime/fraud, a citizen must know "the charge" before he or she can hope to offer a meaningful response. And the difference between a meaningful answer and an unwittingly nonresponsive answer invariably dictates different results.

2. The IRS Hypothesis Posited Two Appellate Levels and Three Years After the Required Response Proves the Clients' Point.

For the first time ever in this case, the Government suggests in its Supreme Court Opposition to Certiorari that Document A-40 may evidence a violation of 26 U.S.C. § 7206(2)[2] (aiding in the filing of a false return). (Opp. at 21). Nowhere in any of its many submissions to the District Court did the IRS point to that statute. Nowhere in its three briefs filed with the Seventh Circuit did the IRS cite or even allude to this statute. As a result, the District Court never notified the Clients that they needed to address that charge in their response to the Court's March 30, 2005 Order and the District Court never identified that statute in its post-response Order of May 17, 2005. For the same reason, the United States Court of Appeals for the Seventh Circuit never mentioned it. To this day, neither the Clients, the Government, nor anyone else can say that the District Court ever thought Document A-40 implicated that unidentified statute.[3]

Therein lies the precise problem presented by this case. Had the Government or the District Court

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[2] Unless indicated otherwise, all Section references are to Title 26 of the United States Code – that is, the Internal Revenue Code of 1986 (as amended through December 31, 2001).

[3] The most the Government can say is that the District Court indicated it was concerned about the "sole purpose" implications of Document A-40, but again, the District Court noted that concern for the first time AFTER the required response by the Clients.

pointed to that statute (or identified any other statute or charge), the Clients could easily have addressed that concern. One, the face of Document A-40 itself reflects the author's reliance upon the controlling precedent of this Court in *Cottage Savings Ass'n. v. Commissioner*, 499 U.S. 554 (1991) – precedent that the Government scrupulously avoids citing and that refutes any suggestion of a violation of the law, much less the "willful" commission of a known (not a debatable) violation of the law that Section 7206(2) requires. Ian M. Comisky et al., *Tax Fraud and Evasion* ¶ 2.03[3][d] and ¶ 2.04[1] (6th Ed. 2007). Two, the unaltered factual findings by the trial court in *Cottage Savings* prove the permissible nature of even a "sole purpose" of tax avoidance:

> We agree with respondent [IRS] that the December 31, 1980, transactions were exchanges, and not independent purchases and sales; that these transactions were ***solely tax-motivated and had no business purpose*** other than to secure refunds of previously paid taxes by generating substantial net operating loss carrybacks.... *Cottage Savings v. Commissioner*, 90 T.C. 372, 385 (1988).

Three, the Government also scrupulously avoids the reality that it urged the same "sole purpose" argument in *Frank Lyon*, *UPS*, *Compaq*, and *IES* without ever once equating "sole purpose" with fraud.[4]

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[4] *Frank Lyon Co. v. United States*, 435 U.S. 561, 582-83, (1973); *United Parcel Serv. of Am. v. Commissioner*, 254 F.3d 1014 (11th Cir. 2001); *Compaq Computer Corp. v. Commissioner*, 277 F.3d

Nor does the Government ever acknowledge that this and those three courts ultimately rejected the Government's "sole purpose" characterization. Would the ultimately vindicated tax practitioners giving advice to *Frank Lyon* be guilty of furthering some crime or fraud? What about the tax practitioners in *Cottage Savings*, *Compaq*, *IES*, and *UPS*?

Four, both the documents the Clients knew the District Court reviewed *in camera* and the attachments to the IRS affidavit (Exhibits A-57 and A-62) proved the presence of a profit motive – not to mention that a number of the Clients are still reaping profits from their distressed debt investments. Remarkably, the Government cites Document A-57, the extraordinarily even-handed tax research memorandum in which one tax practitioner noted to another tax practitioner that a potentially adverse interpretation of a tax statute (Section 475) would "render [the investment] useless for our [*i.e.*, the tax practitioners'] purposes." (Opp. at 20). That passage and that memorandum, of course, reflect the tax practitioner's genuine interest in complying with the tax law, unwillingness to violate the tax law, and commitment to obtaining further advice from counsel – the antithesis of fraud. The startling aspect, however, lies in the Government pointing to Document A-57 as proof of sole tax purpose without once mentioning that the very next paragraph in the very same document reflects that even the tax practitioners noted that the distressed debt trader "thinks [the

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778 (5th Cir. 2001); *IES Indus., Inc. v. Commissioner*, 253 F.3d 350 (8th Cir. 2001).

distressed debt packages] will yield very good profits for investors." So too, the Government never mentions the Document A-62 reference by the same tax practitioner to another statement by the same trader that certain distressed debt includes a "kicker" with "a bonus payoff of probably around 12:1."

As a matter of law, another aspect of Section 7206(2) (which the Government also avoids) precludes application of that statute to Document A-40. At the time the tax practitioner authored A-40 relating to "*Cottage Savings*" and even today, the favorable distressed debt treatment in this Court's *Cottage Savings* opinion represents the dominant authority directly on point. As the treatise cited by the Government verifies, both the law and common decency confirm that criminal tax provisions like Section 7206(2) are no place to pioneer new frontiers in the tax law. Comisky, ¶2.03 [3][d]; *United States v. Garber*, 607 F.2d 92, 100 (5th Cir. 1979) (Section 7201 "is an inappropriate vehicle for pioneering interpretations of tax law"); *United States v. Dahlstrom*, 713 F.2d 1423, 1428 (9th Cir. 1983) ("We are convinced that the legality of the tax shelter program advocated by the appellants in this case was completely unsettled by any clearly relevant precedent on the dates alleged in the indictment. 'It is settled that when the law ... is highly debatable, a defendant actually or imputedly lacks the requisite intent to violate it'"); *United States v. Critzer*, 498 F.2d 1160, 1163 (4th Cir. 1974) ("pioneering interpretations of tax law should not be sought or rendered in criminal prosecutions under § 7201, but rather in civil suits"). Not even the IRS published its opposition to these

distressed debt investments until 2007[5] – SIX YEARS AFTER THE CREATION OF A-40. How can a single email constitute *prima facie* evidence of an unidentified crime/fraud as to what was then a debatable but uncontested position supported by favorable Supreme Court authority?

3. Few, If Any, Cases Present a Cleaner Vehicle for Analyzing a Broader, More Important, and Longer-Neglected Principle.

Seventy-five years have passed since this Court last addressed the crime/fraud exception squarely. That is no accident: the everyday rules that practitioners need rarely garner guidance from this Court because they rarely survive a trial on the merits and even more rarely survive an appeal. Because those principles affect all areas of the law, more guidance, not less, is needed. Nonetheless, the Government dismisses these common questions as unwarranted "interlocutory" rulings but equal application of that reasoning would have deprived practitioners of cases such as *Hickman v. Taylor*, 329 U.S. 495 (1946) and so many of the daily tools of justice that affect every area of substantive law. Indeed, 18 out of the 21 privilege cases cited by the Client/Intervenors (including this Court's opinion in *United States v. Zolin*, 491 U.S. 554 (1989)) and 12 of the 14 privilege cases cited by the Government would be excluded by its interlocutory contention. Still,

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[5] *See 2007 IRS Distressed Debt Coordinated Issue Paper*, 2007 WL 1511543 (IRS) (April 18, 2007) cited at both Pet. Br. fn. 6 and Resp. Opp. fn. 3.

the Government seeks to stretch the 75-year void to untold lengths.

Because the now 75 year old *Clark* opinion spoke in broad phrases susceptible to varying constructions, the Courts of Appeal diverged down at least four different paths, some of which run in the parallel directions as the Government notes but at least two of which collide with each other from opposite directions. That collision not only obliterates the ability of any lawyer, law student, or now accountant to state a single consistent rule: it strikes to the fundamental right of every litigant to know the basis for any (reckless) crime/fraud allegation. Indeed, the looser the standard for leveling an unidentified crime/fraud allegation, the greater its function as an improper litigation tactic.

No case presents a cleaner instrument for the much needed statement of a simple straightforward rule – for several of the reasons the Government notes. One, concentration on a single email does more than just highlight how easily anyone's life can be scarred by an unidentified crime/fraud allegation. That one email allows the Court to address the rule with a clarity that would be lost in the face of one thousand documents. Two, that one email better isolates the difference in the litigant's ability to respond to an identified allegation and inability to respond to an unidentified allegation – with the inevitable difference in results. Three, that one email presents a cleaner test for the distinction between *prima facie* evidence of fraud and non-fraud. And four, while the Seventh Circuit's ruling on Document A-40 is final (subject only to this appeal), this Court's experience in *United States v. Arthur Andersen & Co.*, 544 U.S. 696 (2005), demonstrates

how this issue and so much more can be lost by way of unfounded allegations that linger.

B. THE GOVERNMENT AVOIDS THE TWO CRITICAL STATUTORY CONSTRUCTION QUESTIONS PRESENTED BY SECTION 7525(b).

Section 7525(b) presents two statutory construction questions that transcend this case. One, should the title enacted by Congress be considered part of the statute as a whole in construing a statute which yielded opposite "plain meanings" to two different courts in the same case? Contrary to the Government's contention, no one suggests that the Section 7525(b) title limits or controls the plain meaning of the text – only that it sheds light upon text that two courts believe support opposite "plain meanings." Yet, the Government at least implies that the words enacted by Congress in the title to Section 7525(b) should be ignored altogether in construing the statute as a whole. (Opp. at 25-27). A tension exists both within Supreme Court precedent and among the Circuits as to what significance titles carry. *Compare Koons Buick Pontiac GMC, Inc. v. Nigh*, 543 U.S. 50, 60 (2004) ("holistic endeavor"); *Bhd of R.R. Trainmen v. Baltimore & Ohio R.R. Co.*, 331 U.S. 519, 528-9 (1947); *Hardin v. City Title & Escrow Co.*, 797 F.2d 1037, 1039 (D.C. Cir. 1986); *House v. Commissioner*, 453 F.2d 982, 987-8 (5th Cir. 1972); *Griffin v. Steeltek, Inc.*, 160 F.3d 591, 594 (10th Cir. 1998). Particularly now that publishers no longer inject unenacted titles, the confused standing of the part of every modern statute that describes its scope and subject matter needs clarification.

The Government dismisses the second statutory construction question under a logic that, if embraced, would forever deprive it of Supreme Court review. That question focuses upon the ***prospective*** change in the statute that Congress concluded was needed to achieve the construction the Government maintains existed prior to the change. The beauty of a code system of laws lies in the ability of Congress to change an existing statute that needs changing and, especially in the tax world, prescribe whether the change is prospective or retroactive. *Hassett v. Welch*, 303 U.S. 303, 314, 58 S. Ct. 559, 505 (1938) ("[A] law is presumed, in the absence of clear expression to the contrary, to operate prospectively"). *See also*, Section 7805(b) (governing retroactivity of IRS regulations). To ignore the significance of a prospective change (like the 2004 amendment to Section 7525(b)) repeals the "prospective" treatment mandated by statute. Yet, the Government argues that the very existence of a subsequent statutory change renders review of its impact on the pre-amendment construction "unwarranted." (Opp. at 25-27). That logic would necessarily preclude review of this important prospective-amendment construction question because of the existence of the amendment itself. That approach places this question squarely within this Court's doctrine of "capable of repetition, yet evading review." *See, e.g., Moore v. Ogilvie*, 394 U.S. 814, 816 (1969) (appeal of election board candidacy denial held "capable of repetition, yet evading review"); *Southern Pacific Terminal Co. v. Interstate Commerce Commission*, 219 U.S. 498, 515 (1911) (under doctrine of "capable of repetition, yet evading review," ICC orders subject to review despite expiration). Hence, the Government's logic for avoiding review defeats itself.

The first of these two questions touches every modern statute and the second touches every statute Congress chooses to change prospectively. They deserve and need this Court's attention.

CONCLUSION

For all of these reasons, the Petition for Writ of Certiorari should be granted.

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